88-1177

No. ———

Supreme Court, U.S.
FILED
JAN 17 1989
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

MUSTANG FUEL CORPORATION (formerly MUSTANG ENERGY CORP.),
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, et al.
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

DAVID O. CORDELL
MUSTANG FUEL CORPORATION
1100 First National Center East
Oklahoma City, Oklahoma 73102
(405) 272-9471

CARROLL L. GILLIAM *
RICHARD A. DROM
CATHERINE E. BOCSKOR
GROVE, JASKIEWICZ,
GILLIAM AND COBERT
1730 M Street, N.W.
Washington, D.C. 20036
(202) 296-2900

* Counsel of Record

January 17, 1989

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

QUESTIONS PRESENTED

This case is the first judicial review of Federal Energy Regulatory Commission ("Commission") orders purporting to fix "fair and equitable" rates under Section 311(a)(2) of the Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. § 3371(a)(2), for natural gas transportation by an intrastate pipeline for an interstate pipeline. Section 311(a)(2) requires, *inter alia*, rates that "reasonably compensate" for "expenses incurred" and provide an "opportunity . . . to earn a reasonable profit" (15 U.S.C. § 3371(a)(2)(B)(ii)). Petitioner, an intrastate pipeline transporting for an interstate pipeline, asserted before the court below that the Commission, in violation of Section 311(a)(2) rate standards and constitutional requirements, had reduced rates and ordered confiscatory refunds because of the combined impact of (1) application, retroactively, of a new hybrid method to reduce rates for past periods; and (2) abrogation, retroactively, of a minimum volume billing provision in the contract between Petitioner and the interstate pipeline customer. The court of appeals disagreed and affirmed the Commission on these issues, remanding only for correction of Commission error in the "actual costs" used for the later of two rate periods involved.

Questions presented are:

1. Whether the Commission misinterpreted, misapplied, and violated standards of Section 311(a)(2) of the NGPA by denial of an intrastate pipeline's recovery of "expenses incurred" and a "reasonable profit" for transportation of natural gas for an interstate pipeline as a direct result of simultaneous (i) retroactive application of new, previously unannounced methods for costs allocation and fixing rates, and (ii) retroactive abrogation of a contract provision permitting a monthly minimum volume charge to the interstate pipeline.

2. Whether the Commission misinterpreted, misapplied, and violated provisions of Section 311(a)(2)(B) of the NGPA which require rates for an intrastate pipeline to be "reasonably comparable" to rates permitted for interstate pipelines, and denied equal protection under the Constitution of the United States, by (i) imposing upon the intrastate pipeline all risks of failure of its interstate customer to project carriage volumes accurately and to use contracted, and projected service, but (ii) allowing in the past, currently, and for the future, interstate pipelines to "share" such risks with their customers by provisions in their tariffs having similar economic and billing effects.

3. Whether the Commission violated Section 311(a)(2) of the NGPA, and requirements of the Fifth Amendment to the Constitution of the United States for due process and nonconfiscatory rates, where the aggregate total impact and end results of retroactive reductions of filed rates, retroactive abrogation of a protective minimum volume charge, and payments of refunds ordered, are based upon:

(i) application to past periods of new, previously unannounced costs allocation and rate-making methods for interstate service without prior notice in time to have permitted timely commensurate costs reallocations and compensating changes of rates for the same past periods for intrastate service not subject to Commission jurisdiction;

(ii) retroactive total abrogation of the protection of a minimum volume charge previously permitted and effective during the past periods; and,

(iii) requirement of refunds payments which deprive the intrastate pipeline of recovery of "expenses incurred" and reasonable profit for the interstate service and exceed then current annual gross revenues for the interstate service and total net income from both interstate and intrastate services.

PARTIES TO THE PROCEEDING

Petitioner Mustang Fuel Corporation (Mustang Energy Corp. while this case was before the court of appeals) ("Mustang") was, during the agency proceedings, owner and operator of a large, extensive intrastate natural gas transportation system in Oklahoma originally serving only customers in that state. Mustang commenced transportation under Section 311(a)(2) of the NGPA for El Paso Natural Gas Company, an interstate pipeline and intervenor below, in September, 1981. In 1986, the system was sold and now is operated by Enogex, Inc., a wholly-owned subsidiary of Oklahoma Gas and Electric Company, which continues service for intrastate and interstate customers. Mustang remains responsible for rates and refunds, if any, for two rate periods covered by the court of appeals opinion and two subsequent rate periods still pending before the Commission (see App., 7a).*

Respondent Federal Energy Regulatory Commission has jurisdiction over transportation of natural gas in interstate comerce and sales of natural gas in interstate commerce for resale under the Natural Gas Act of 1938, 15 U.S.C. §§ 717, *et seq.*, ("NGA") and certain transportation and sales under the Natural Gas Policy Act of 1978, 15 U.S.C. §§ 3301, *et seq.*, including transportation of natural gas by an intrastate pipeline on behalf of an interstate pipeline under Section 311(a)(2) of the Natural Gas Policy Act, 15 U.S.C. § 3371(a)(2).

El Paso Natural Gas Company, Mustang's interstate transportation customer, is a wholly-owned subsidiary of Burlington Resources Inc., and was an intervenor in the court below and in Commission proceedings.

---

* In accordance with Rule 28.1, the list of Mustang Fuel Corporation's parent companies, subsidiaries (except wholly-owned subsidiaries), and affiliates is set forth in App., 104a.

TABLE OF CONTENTS

	Page
OPINIONS AND ORDERS BELOW	1
JURISDICTION	2
STATUTES AND REGULATIONS INVOLVED	2
STATEMENT OF THE CASE	2
1. Statutory Background	3
2. The Mustang-El Paso Transportation Agreement	4
3. Commission Proceedings	6
4. The Decision Below	12
REASONS FOR GRANTING THE PETITION	16
I. Importance of Section 311(a)(2) of the NGPA	17
II. Erroneous Interpretations and Applications of Decisions of This Court	21
III. Courts of Appeals Conflicts	26
CONCLUSION	29
APPENDICES	1a*

* The Appendices required by Rule 21.1(k) and the listing required by Rule 28.1 are separately bound.

TABLE OF AUTHORITIES

Cases: Page

ANR Pipeline Company v. FERC, —— F.2d —— (D.C. Cir. No. 87-1340 *et al.*, Dec. 13, 1988) 26-27
Associated Gas Distributors v. FERC, 824 F.2d 981 (D.C. Cir. 1987), *cert. denied*, —— U.S. ——, 108 S.Ct. 1468 (1988) 21
Chemical Manufacturers Association v. Natural Resources Defense Council, Inc., 470 U.S. 116 (1985) 21-22
Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984) 21-22
Colorado Interstate Gas Company v. FERC, 791 F.2d 803 (10th Cir. 1986) 14-15, 26-27
Colorado Interstate Gas Company v. FPC, 324 U.S. 581 (1945) 24
City of Batavia v. FERC, 672 F.2d 64 (D.C. Cir. 1982) 26-27
Duquesne Light Co., et al. v. Barasch, et al., —— U.S. —— (No. 87-1160, January 11, 1989) 18, 23, 25
East Tennessee Natural Gas Company v. FERC, —— F.2d —— (D.C. Cir. No. 87-1765, Dec. 9, 1988) 26-27
FPC v. Hope Natural Gas Co., 320 U.S. 591 (1944) .... *passim*
Jersey Central Power & Light Co. v. FERC, 810 F.2d 1168 (D.C. Cir. 1987) 27-28
Laclede Gas Company v. FERC, 670 F.2d 38 (5th Cir. 1982) 27
Martin Exploration Management Company v. FERC, 813 F.2d 1059 (10th Cir. 1987), *rev'd on other grounds*, 108 S.Ct. 1765 (1988) 12
Mobil Oil Corp. v. FERC, 417 U.S. 283 (1974) 14
Nantahala Power and Light Company v. Thornburg, 476 U.S. 953 (1986) 24
Permian Basin Area Rate Cases, 390 U.S. 747 (1968) .... *passim*
Public Service Co. of New Mexico v. FERC, 832 F.2d 1201 (10th Cir. 1987) 14
Vermont Yankee Nuclear Power Corporation v. Natural Resources Defense Council, Inc., 435 U.S. 519 (1978) 10

TABLE OF AUTHORITIES—Continued

Administrative Decisions:	Page
Mustang Fuel Corporation, 19 F.E.R.C. (CCH) ¶ 61,168 (1982)	5-6
Mustang Fuel Corporation, 20 F.E.R.C. (CCH) ¶ 61,057 (1982)	5-6
Mustang Fuel Corporation, 31 F.E.R.C. (CCH) ¶ 61,265 (1985)	1
Mustang Fuel Corporation, 36 F.E.R.C. (CCH) ¶ 61,001 (1986)	1
The Constitution, Statutes and Regulations:	
Fifth Amendment to the Constitution of the United States	10, 28
Administrative Procedure Act, 5 U.S.C. § 551 *et seq.* (1982)	10
Federal Power Act, 16 U.S.C. § 791a-825r (1985)	18, 28
Natural Gas Act of 1938, 15 U.S.C. § 717, *et seq.* (1976)	*passim*
Natural Gas Policy Act of 1978, 15 U.S.C. §§ 3301-3432 (1982)	*passim*
§ 311(a)(2), 15 U.S.C. § 3371(a)(2)	*passim*
§ 311(a)(2)(A), 15 U.S.C. § 3371(a)(2)(A)	3
§ 311(a)(2)(B)(i), 15 U.S.C. § 3371(a)(2)(B)(i)	3
§ 311(a)(2)(B)(ii), 15 U.S.C. § 3371(a)(2)(B)(ii)	3
§ 506(a)(4), 15 U.S.C. § 3416(a)(4)	2
Regulations Under the Natural Gas Policy Act, 18 C.F.R. §§ 284.121, *et seq.*	*passim*
§ 284.123(b)(2)	4
Miscellaneous:	
H. Rep. No. 95-543, 95th Cong. 1st Sess. 45 (1977), *reprinted in*, 1978 U.S. Code Cong. & Admin. News 7712	19

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

No. —

MUSTANG FUEL CORPORATION (formerly MUSTANG ENERGY CORP.),
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

Mustang Fuel Corporation, formerly Mustang Energy Corp., ("Mustang") hereby petitions for a writ of certiorari to review the decision of the United States Court of Appeals for the Tenth Circuit in this case.

OPINIONS AND ORDERS BELOW

The opinion of the court of appeals (App., 1a-31a) is reported at 859 F.2d 1447 (10th Cir. 1988).[1] The orders of the Federal Energy Regulatory Commission on review are reported at 31 F.E.R.C. (CCH) ¶ 61,265 (1985) (App. 34a-62a) and 36 F.E.R.C. (CCH) ¶ 61,001 (1986) (App., 63a-93a).

---

[1] Appendices to this Petition are contained in a separate volume.

JURISDICTION

The judgment of the court of appeals was entered on October 17, 1988 (App., 32a-33a). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254 and Section 506(a)(4) of the Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. § 3416(a)(4).

STATUTES AND REGULATIONS INVOLVED

Section 311(a)(2) of the NGPA, 15 U.S.C. § 3371 (a)(2), is set out at App., 94a-95a. Subpart C of Part 284 of the Regulations under the Natural Gas Policy Act of 1978, 18 C.F.R. §§ 284.121 *et seq.*, is set out at App., 96a-103a.

STATEMENT OF THE CASE

This case is the first judicial review of Federal Energy Regulatory Commission ("Commission") orders prescribing rates for an intrastate pipeline transporting natural gas on behalf of an interstate pipeline under substantive requirements of Section 311(a)(2) of the NGPA (See App., 8a-9a).

The Commission orders (1) changed methods previously used to design Mustang's rates and applied the new methods retroactively to reduce the filed rates (App., 40a-50a, 68a-72a); (2) abrogated, retroactively, the minimum volume charge for billing provided for in the contract between Mustang and its interstate pipeline customer (App., 34a, 52a-57a, 63a, 72a-80a); and (3) directed substantial refunds even though aggregate impact and end results of Commission actions, in combination, are to deprive Mustang of recovery of expenses incurred and a "reasonable profit" for the interstate pipeline service during the 1982-1984 rate periods subject to these orders (App., 68a-72a, 82a-84a).

The court of appeals affirmed the Commission on all questions as to lawfulness of these actions and results under substantive standards of the NGPA and constitutional requirements applicable to design and fixing of rates (App., 2a, 18a-24a, 25a-31a). The court remanded the case only to permit Commission correction of its erroneous use of the wrong "actual cost" data for the most recent rate period covered by the orders, a correction having only negligible change in the total dollar impact of the Commission orders (App. 24a-25a, 31a).

1. *Statutory Background.* Under Section 311(a)(2) of the NGPA, the Commission may authorize intrastate pipeline transportation of natural gas on behalf of an interstate pipeline or local distribution company, 15 U.S.C. § 3371(a)(2)(A) (App., 94a-95a). Maximum rates and charges for such service must be "fair and equitable" and not in excess of an amount "reasonably comparable" to rates and charges permitted for interstate pipelines for similar services (15 U.S.C. § 3371 (a)(2)(B)(i), App., 94a-95a). The Commission is directed to establish the method for calculating "an amount necessary" to: (1) reasonably compensate for "expenses incurred" in authorized services, and (2) provide "opportunity" for the intrastate pipeline "to earn a reasonable profit" on its services (15 U.S.C. § 3371 (a)(2)(B)(ii), App., 95a).

Section 311(a)(2) was intended by Congress to create development and integration of a national natural gas transportation network without subjecting intrastate pipelines to regulation under the Natural Gas Act of 1938, 15 U.S.C. §§ 717, *et seq.* ("NGA"). Under Section 311 (a)(2), the only operations of an intrastate pipeline subject to federal regulation thus are specific transactions for transportation on behalf of an interstate pipeline or a local distribution company (see App., 5a-6a).

Commission regulations implementing Section 311 (a)(2) provide that intrastate pipelines may elect to

base rates for interstate service on methodology used by, or rates on file with, their respective state regulatory agencies. If a pipeline does not so elect or is not state regulated (as is the case of Mustang), the pipeline must apply for Commission approval of rates under Section 311(a)(2). Upon filing a petition for such approval, the pipeline may begin service and charge the filed rates, subject to refund. For 150 days, the Commission then has discretion to permit those rates to be "deemed" consistent with substantive standards of Section 311(a)(2) or to initiate a "legislative-type," non-adjudicatory rate review proceeding and thereafter approve the filed rate or disapprove the rate and order refunds, with interest, of any amounts determined to be "excess" collections. See 18 C.F.R. § 284.123(b)(2); App., 98a; and App., 4a, n.1.

2. *The Mustang-El Paso Transportation Agreement.* Prior to 1981, Mustang provided natural gas transportation only for intrastate customers within Oklahoma. On January 9, 1981, Mustang contracted with El Paso Natural Gas Company ("El Paso"), an interstate pipeline, to provide transportation of natural gas to be purchased by El Paso in Oklahoma, then transported to El Paso's interstate system by two intrastate pipelines, and then further transported by El Paso and resold by El Paso in interstate commerce (App., 2a, 34a-35a). Under this contract, El Paso is required to provide annually to Mustang El Paso's projections of the volumes Mustang will be responsible for transporting for El Paso in the ensuing twelve months, the same procedures used by Mustang's intrastate transportation customers (App., 40a-42a).

Under the contract, Mustang's rates are computed and determined in steps: (1) El Paso provides its volume projections, and contemporaneous, similar twelve-month projections are provided by Oklahoma Gas and Electric Company ("OG&E"), Mustang's major intrastate custo-

mer;[2] (2) Mustang projects its total costs for the same future twelve-month periods, using past historical costs adjusted for known and anticipated changes; (3) the total of Mustang's projected costs then is allocated between OG&E and El Paso on the basis of the projected volumes provided to Mustang by them; and (4) precise unit rates per thousand cubic feet (Mcf) for the volumes to be transported for El Paso and for OG&E are determined by dividing the projected costs allocated to each of them by the projected transportation volumes supplied to Mustang by each of them (App., 41a-42a).

The Mustang-El Paso contract also provides for El Paso's review and possible change of its projected volumes and of Mustang's projected costs, at least annually, and for changes of Mustang's rates, if required after such review (App. 35a). If and when such changes are made by the contract parties, Mustang then must file changed rates for Commission review, and El Paso may participate in such review.[3]

El Paso also agreed to pay Mustang a monthly billing for a minimum volume charge determined by use of El Paso's annual volumes projections. This provision was intended by the parties to ensure availability of transportation capacity on Mustang's system for El Paso's protection, commensurate with market demands *and* avoidance by El Paso of payments by El Paso for El Paso's contractual take-or-pay obligations to Oklahoma producers and sellers to El Paso. Annual review of the minimum volume is contemplated, with changes to

---

[2] A portion of costs applicable to a part of Mustang's system serving Mustang's other intrastate customer, Public Service Company of Oklahoma, is excluded from computations of El Paso's rates under the Mustang-El Paso agreement (App., 40a-42a). Therefore, OG&E and El Paso projected volumes and allocations of Mustang's projected costs to OG&E and El Paso are used .

[3] *See Mustang Fuel Corporation,* 19 F.E.R.C. (CCH) ¶ 61,168 (1982); *Mustang Fuel Corporation,* 20 F.E.R.C. (CCH) ¶ 61,057 (1982).

be made by El Paso from time to time (App., 6a, 25a-26a, 52a, 72a).[4]

3. *Commission Proceedings.* Mustang initiated service under Section 311(a)(2) of the NGPA for El Paso for two years on September 30, 1981, but the contract later was amended to provide for a fifteen-year service term. As required by the Regulations, Mustang filed for authorization of both short-term and long-term transportation agreements and approval of an initial rate of 22.29 cents per Mcf for the El Paso service. This rate was fixed by the allocation and rate design methods summarized, *supra* (*i.e.*, use of El Paso's and OG&E's projected transportation volumes for the next twelve months and Mustang's projected costs for the same twelve-month period) (App., 41a-42a).

In the 1981-1982 review of this initial rate, the same costs allocation and rate design methods were used by Commission Staff (App., 42a-43a). After review by the Staff and Commission, orders were issued on May 20, 1982 and July 19, 1982 approving the initial rate so fixed by this costs allocation and rate design methodology and requiring no change of the monthly minimum volume billing charge, as provided for in the contract (App., 35a-36a).[5] However, the Commission required Mustang

---

[4] As the Commission record shows, El Paso initially estimated a required transportation throughput capacity on Mustang's system in excess of 200,000 Mcf per day, based upon El Paso's 1980-1982 planned system expansion and sales increases. The initial volume for a minimum volume charge, or "monthly demand charge", to be used by Mustang in monthly bills then was fixed at 130,000 Mcf per day, which is 65% of the initial El Paso planned throughput. This volume of 130,000 Mcf per day was not changed by El Paso between September, 1981 and May, 1983. The volume figure then was reduced by El Paso to 58,000 Mcf per day for the period from May 22, 1983 through April 30, 1984 (see App., 6a, n.4, 52a-54a).

[5] These 1982 orders are reported as *Mustang Fuel Corporation*, 19 F.E.R.C. (CCH) ¶ 61,168 (1982), and *Mustang Fuel Corporation*, 20 F.E.R.C. (CCH) ¶ 61,057 (1982).

(1) to make future filings annually to "justify" the El Paso rate; and (2) to use, in future filings, an assumed, "imputed" throughput volume for determining unit cost of use of Mustang's Cogar Compression Station (see App., 35a-36a, 50a-52a). Thereafter, Mustang, Staff, and the Commission all treated the four-part "give-and-take" substance of these 1982 orders as a settlement; and the Commission so refers to this approval of the initial rate as a "settlement" (App., 35a, 63a, 67a).

On September 30, 1982, Mustang filed the first of the compulsory annual petitions, providing Mustang's projected costs and projected volumes by El Paso and OG&E for the next twelve-month period and based thereon, a rate increase to 32.21 cents per Mcf, effective October 1, 1982. Prior to action on that petition, Mustang, on May 23, 1983, filed another petition required by reduction of the minimum volume used in the monthly bill to El Paso from 130,000 Mcf to 58,000 Mcf per day. Mustang also submitted projected costs and El Paso's and OG&E's projected volumes for the twelve-month period commencing May 1, 1983, which resulted in an increase in the rate to be charged El Paso from 32.21 to 34.30 cents per Mcf (App., 36a).

The Commission then initiated its "legislative-type" hearing on May 30, 1984 before a Panel of Staff personnel; and, after that proceeding and receipt by the Panel of written and oral submissions by Mustang and Commission Staff, the Commission received this Staff Panel's recommended decision, which neither Staff nor the Commission make available to an intrastate pipeline for review, comment, exceptions, response, or rebuttal (App., 36a, 58a-61a, 80a-82a).

On June 4, 1985, the Commission issued the first order on review (App., 34a) (1) directing reductions in Mustang's rates charged El Paso for both then past rate periods; (2) abrogating, retroactively to the date of initial delivery, use of the minimum volume charge in

monthly billing; and (3) ordering refunds to El Paso, with interest, of all amounts collected under that contract provision on and after September 1, 1981, and of "excess" amounts collected between October 1, 1982, and April 30, 1984, at the filed rates higher than the Commission-prescribed rates (App., 34a-62a).[6]

On questions raised by retroactive application of the new costs allocations and rate design methods, the Commission:

(1) rejected continued use of the "projected costs-projected volumes" method of allocating costs and rate design methods contemplated by contract and used to allocate costs between OG&E and El Paso, to determine unit costs and rates of OG&E and El Paso, and in the 1982 approval of Mustang's initial rates (App., 41a-42a, 50a); despite the fact that such retroactive change *in 1985* of costs allocations and rate design for October 1, 1982-April 30, 1984 came too late for Mustang to make parallel commensurate, retroactive reallocations of costs and changes of the past period rates for unregulated intrastate service for OG&E (App., 24a);

(2) adopted, and made public for the first time, a new hybrid methodology (which neither Mustang nor Staff had ever used or proposed) using a combination of "projected volumes" and Staff calculations of "actual costs" for the twelve months from October 1, 1982 through September 30, 1983 (App., 50a);

(3) adopted, at least in theory, the same newly-disclosed hybrid methodology for the second and later rate period (May 23, 1983 through April 30, 1984), but here used a mismatch of the projected volumes for the period and the same Staff's calculation of "actual costs"

---

[6] As of 1986, after Commission modification of its order on rehearing, the total refunds ordered, including interest, exceeded $11,000,000 (see App., 89a, n.30).

for the twelve months from October 1, 1982 through September 30, 1983, on the asserted ground that "actual costs" for this second, later period had not been submitted (App., 40a, 69a);[7] and,

(4) determined lower unit costs, fixed lower transportation rates for the El Paso service, and ordered refunds of collections of amounts collected at the filed rates in excess of amounts computed at the Commission-prescribed rates (App. 61a-62a).

The same June 4, 1985 order set out Commission rationale for prohibiting use of the contract minimum volume billing provision, the retroactive abrogation, and the striking of the provision from Mustang's rate structure (App., 52a-57a). The Commission views were that this contract provision placed "unwarranted risks" on El Paso's interstate customers through any "underutilization" of Mustang's facilities by El Paso and operated to shift the "risk" of errors in projections of market demand by El Paso (and its customers), and of El Paso's need for transportation on Mustang's system, from Mustang to El Paso (App., 53a). The Commission reasoned that if Mustang transported lower volumes than El Paso had projected, Mustang could "overrecover" costs (App., 54a); stated that its "policy" is that interstate customers "should not bear unwarranted risk" of an interstate pipeline's underuse of an intrastate pipeline's facilities (App., 54); and asserted that in prior orders under Section 311, "minimum bills" had been rejected (App., 54a-55a).[8]

---

[7] The court of appeals reversed the Commission only as to this error in use of this inapplicable, obsolete "actual cost" data for the second rate period from May 23, 1983 through April 30, 1984 (App., 24a-25a).

[8] In this June 5, 1988 order, the Commission also rejected a proposed amendment to the contract, agreed upon by El Paso and Mustang, submitted after Staff statements of position. Under this amendment, effective January 1, 1984, El Paso would have been

The Commission further found its prescribed rates "reasonably comparable" to rates an interstate pipeline would be allowed (App., 53a); denied Mustang's motion for oral argument (App., 58a-59a); and rejected Mustang arguments that procedures used deprived Mustang of a fair hearing consistent with requirements of the Administrative Procedure Act, 5 U.S.C. §§ 551 *et seq.* (1982), the NGPA, and due process of law under the Fifth Amendment (App., 59a-61a).[9]

On July 1, 1986, the Commission issued its order on Mustang's request for rehearing and rejected most of Mustang's assertions of errors (App., 63a-91a (Commissioner Trabandt dissenting)). The Commission adhered to its retroactive application of the new hybrid methods of costs allocations and rate design, including the error of mismatches in time of projected volumes and "actual cost" data used for the second rate period, even though updated data were submitted in Mustang's request for rehearing (see App., 61a and 68a-72a).

The Commission refused to use new volume and cost data submitted by Mustang responsive to the June 5,

---

given the right to make up volumes within three years of any minimum volume billing, and Mustang would have transported volumes at no additional charge to El Paso as long as El Paso also was tendering the minimum daily quantity in effect from time to time (App., 53a).

[9] Mustang asserted denials of procedural rights because of lack of opportunity for oral argument at Commission level; Commission simultaneous use of Staff personnel as "prosecutorial" or "advocacy" counsel, as members of the Panel "hearing" presentations, as witnesses before the Panel who could not be cross-examined, and as authors of the recommended decision to the Commission, which is not made public or available to parties for review, response, or rebuttal at Commission level (App., 58a-61a). *Inter alia*, the Commission cited this Court's decision in *Vermont Yankee Nuclear Power Corporation v. Natural Resources Defense Council, Inc.*, 435 U.S. 519 (1978), as support for its conclusions of no error by it and its statement that no "right to respond" exists "in an informal rulemaking" (App., 61a and n.51).

1985 order, including alternative cost-of-service presentations matching "projected costs" and "projected volumes" and "actual volumes" and "actual costs" for each rate period before the Commission (App., 68a-72a). Mustang also had submitted data showing that as a result of retroactive abrogation of the minimum volume billing contract provision, rate reductions, and refunds, the Commission violated Mustang's rights under the NGPA to recover "expenses incurred" and a "reasonable profit" and had imposed confiscatory rates (App., 82a-84a, 92a-93a). The Commission rejected these arguments and made no changes except to permit refund payments to El Paso to be spread over two years because of recognized "hardship" to Mustang of an immediate "lump sum" payment (App., 70a-72a, 82a-83a).[10]

The Commission changed its abrogation of the minimum volume charge billing provision only to rescind the abrogation for the first twelve-month period of Mustang's service for El Paso (from September 1, 1981 through September 30, 1982), which was covered and closed by the Commission's 1982 orders (App., 72a-76a). For the two subsequent periods and the future, the Commission concluded that importance of this provision to Mustang as "consideration" for the entire fifteen-year term of the amended contract was "insufficient grounds" to support it (App., 76a-77a); the abrogation, the control thereby given to El Paso, and the resultant shifts of all risks of El Paso's errors to Mustang could be minimized by "self-help" and by Mustang's filing of future rate increases with the Commission (App., 77a); and Mustang, not El Paso or its customers (who make the market and utilization projections), must bear risks of their errors in projections and any later underuse of Mustang's system by El Paso (App., 78a).

---

[10] Mustang had shown in its request for rehearing that refunds under the June 5, 1985 order would exceed its then current *total annual collections* from El Paso *and* Mustang's *net income* from *all* of its services to *all* of its customers (App., 83a).

The Commission also found no "disparate treatment" by it of intrastate and interstate pipelines, or unfair discrimination against intrastate pipelines, in eliminating such provisions from rate structures (App., 78a-79a). The Commission also adhered to the conclusions in its June 5, 1985 order as to denial of due process (App., 80a-82a), and payment of interest on refunds, attributing some of its own delays to the "novel nature" of the case and "wealth of issues" raised (App., 84a-85a).[11]

3. *The Decision Below.* The court of appeals affirmed the Commission (App., 2a-31a) except to modify the Commission's July 1, 1986 order to direct the Commission to recalculate the second period rate (May 23, 1983-April 30, 1984) by use of "actual cost data" for that specific period (App., 24a-25a, 31a-33a).

After setting out a brief procedural history, statutory provisions, the regulations, and limited excerpts from legislative history (App., 2a-8a), the court did correctly state:

> "Apparently, we are the first court to consider the 'fair and equitable' rate standard of Section 311 (a) (2). Thus our review focuses on two questions: first, has FERC properly interpreted the statutory language; and second, has FERC properly applied the standard in this case?" (App., 8a-9a, n. omitted).

The court then stated that its "standard of review" is "necessarily deferential" to Commission interpretation of statutory language (App., 9a), quoting extensively from its opinion in *Martin Exploration Management Company v. FERC*, 813 F.2d 1059 (10th Cir. 1987), but noting that opinion was reversed "on other grounds" by this Court (App., 9a-10a).

---

[11] The Commission also rejected an Offer of Settlement by Mustang, supported by El Paso and OG&E, but opposed by Commission Staff (App., 85a-90a).

The court found that the "fair and equitable" standard of Section 311(a)(2) is "subject to a variety of interpretations" (App., 10a), and that "neither FERC regulations nor adjudications provide a clear, concise statement of the Commission's interpretation of the statute" (App., 12a). Nevertheless, the court accepted the Commission view that Section 311(a)(2) should be implemented "through traditional cost-of-service ratemaking" (App., 12a). Then, after discussion of its perception of differences between the Commission and Mustang as to interpretation and application of the several mandatory substantive rate standards in Section 311(a)(2), the court accepted Commission "rationale" as to "risk allocation," its imposition of the risks upon Mustang, and its interpretation of the statutory standard as "reasonable" and conforming to "stated Congressional policies" (App., 13a-18a).

The court "characterized" the "dispute" over statutory interpretation and application as a "question of risk allocation" (App., 14a), on the assumption in this part of the opinion and elsewhere that Mustang seeks a "protected" "guarantee" under Section 311(a)(2), of recovery of its incurred expenses and a "reasonable profit," and a "preferred status," regardless of the obvious contract and statutory ceilings on rates filed by Mustang (App., 14a, 18a, 24a, 29a). Yet, elsewhere in the opinion, the court seems to have recognized that this was not Mustang's position, but that, by its petition for review, Mustang sought only (1) reversal of the Commission on the retroactive changes of methodology and retroactive abrogation of the minimum volume charges; (2) relief from the confiscatory refund requirements (App., 8a); (3) "opportunity for profit" as limited by the Mustang-El Paso contract and the filed rates (App., 13a); and (4) did *not* seek "rates," cost recovery, or "profit" in excess of that allowable and recoverable through those rates and the minimum charge for these past periods (App., 25a; see also App., 69a-72a, 82a).

Further, throughout its opinion, *despite plain, obvious differences in controlling language in Section 311(a)(2) of the NGPA and in the Section 4 and 5 rate provisions of the NGA*, the court based its review of this NGPA section and its approval of Commission interpretation and application of Section 311(a)(2) *solely* upon the court's interpretation of prior decisions of the courts under the NGA (App., 17a, 18a).[12] Its ultimate conclusions were the propositions that: (1) the "statute and legislative history" of the NGPA indicated "interstate ratepayers" were to be protected under the NGA and are not to bear "financial risks" of interstate pipelines' transportation agreements under Section 311(a)(2), even though Congressional intent had been read to mean that intrastate pipelines were to be encouraged to enter and "compete in the transportation market" without burdens of "full regulation" under the NGA; and (2) no "preferred status" or "financial guarantees" were intended for intrastate pipelines under the NGPA (App., 18a). Upon these predicates, the court then concluded it must "defer" to the agency interpretation of the "fair and equitable" standard and its allocation of "risks of underutilization in setting transportation rates" (App., 18a).

As its basis for all this "deference," the court of appeals stated that this Court's opinions adopt an "extremely deferential standard of review" in NGA rate cases, concluding the court, therefore, must apply "the same standard" as to whether the Commission properly applied substantive mandates and standards of Section

---

[12] Among other NGA cases, the court of appeals cited, relied upon, or quoted from *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944); *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968); *Mobil Oil Corp. v. FERC*, 417 U.S. 283 (1974); *Colorado Interstate Gas Co. v. FERC*, 791 F.2d 803 (10th Cir. 1986); and *Public Service Co. of New Mexico v. FERC*, 832 F.2d 1201 (10th Cir. 1987). (*See* App., 17a).

311(a)(2) of the NGPA (App., 18a-19a). This Court's opinions, under the NGA, so read and deemed controlling, then were said to require a "presumption of validity", impose a "heavy burden" upon any petitioner, direct no court obligation to examine "each detail" of a rate order, and hold that judicial inquiry ends if "total effect" of a rate order appears not "unjust" and "reasonable" (an NGA Section 5 standard), but judicial review does permit inquiry as to whether "essential elements" of a rate order are supported by "substantial evidence" (App., 19a).[13]

Under its readings of these NGA case opinions as to "standards" of review and its own functions, the court of appeals then deferentially affirmed the sudden Commission changes of methodology and use of the hybrid combination of "projected volumes" and "actual costs" to test and fix rates, and rejected Mustang's objections to these parts of the Commission's orders. However, the court did state:

> "While we might view the question differently than FERC, the Commission's decision is supportable." (App. 21a).[14]

The court of appeals further (1) held there had been no unlawful "retroactive ratemaking", relying upon its decision as to Section 4 of the NGA in *Colorado Interstate Gas Company v. FERC*, 791 F.2d 803 (10th Cir.

---

[13] The court of appeals did not state or mention that *each* of the major opinions in NGA cases it cited, relied upon, and "adopted" were in cases, unlike Section 311(a)(2) procedures, in which adjudicatory hearings had been held before the Commission under the NGA and the APA, findings of fact were made upon the basis of a record so developed, and "evidence," considered "substantial" or otherwise, was available in records so developed by the agency to be reviewed by Courts on the basis of such records.

[14] As stated by the court below: "Normally, because rates are calculated prospectively, regulations use projected cost and volume data." (App., 23a, n.16).

1986) (App., 22a-23a); (2) found no error in retroactive abrogation of the contractual minimum volume billing charge; (3) "found no reason to review the history of FERC's minimum bill policy," and did not refer to or apply any applicable NGA precedents or accord any weight to the Commission's concession that it had permitted such charges for "interruptible" and "firm" service by interstate pipelines (App., 27a-28a) and now allows economic equivalents of such charges as "standby" charges (App., 28a-29a): (4) held the refund order not to be "confiscatory" or "unconstitutional" (App., 29a); (5) upheld the imposition of interest on refund principal amounts (App., 29a-30a); and (6) found no denial by the Commission of procedural due process of law (App., 31a).

REASONS FOR GRANTING THE PETITION

This case presents important questions of first impression in construction and application of substantive rate standards for intrastate pipeline transportation of natural gas under the Natural Gas Policy Act of 1978. The questions presented were wrongly decided by the Tenth Circuit in this first judicial review of Commission-prescribed rates under Section 311(a)(2) of the NGPA. The decision below is contrary to the intent of Congress in enacting Section 311(a)(2) and approves confiscatory rate and refund orders which violate the NGPA and constitutional requirements in federal rate regulation.

Consideration and decision by this Court, at the earliest possible date, are warranted fully because of importance of these questions in rate regulation under this NGPA section. This section was intended to move the natural gas industry rapidly toward full integration of intrastate and interstate natural gas transportation systems, for the benefit of interstate markets, by encouraging commitments by intrastate pipelines to long-term

services and transactions with interstate pipelines and local distribution companies, even though certain intrastate pipelines' transportation rates would be subjected to Commission review and modification under Section 311 (a) (2).

In this first judicial review, the court of appeals erred in affirming Commission statutory interpretation and application of the rate tests mandated by Congress in Section 311(a)(2); in interpreting and applying, as "borrowed" controlling precedent, constructions of the NGA by this Court; and in similarly "borrowing," as controlling precedent, Tenth Circuit constructions of the Natural Gas Act which are in conflict with constructions of the same section of that statute by the District of Columbia Circuit. The Tenth Circuit also has affirmed orders directly in conflict with the Congressional mandates in Section 311(a)(2) for "fair and equitable," non-discriminatory treatment of intrastate pipelines, which direct the Commission to permit intrastate pipelines providing the sought-for service to and for the interstate market, rates "reasonably comparable" to those of interstate pipelines providing similar service.

I. Importance of Section 311(a)(2) of the NGPA.

In so affirming Commission orders requiring refunds by an intrastate pipeline for transportation for an interstate pipeline, the court of appeals' errors were its (1) absolute failure to assess aggregate total impact and end results of the orders under statutory and constitutional requirements; (2) misconstruction and misapplication of the decisions of this Court as to statutory and constitutional requirements in rate cases under the NGA, which the court below borrowed and treated as controlling upon the NGPA rate standards; and (3) similar error in borrowing and treating as controlling, the Tenth Circuit constructions of Section 4 of the NGA in conflict with those

of the District of Columbia Circuit and parallel, comparable sections of the Federal Power Act ("FPA").[15]

Such an opinion cannot be reconciled with any of the directives of Congress to the Commission in Section 311(a)(2) of the NGPA that the Commission "shall" allow intrastate pipelines "fair and equitable" rates and provide the opportunity to recover "expenses incurred," a "reasonable profit", and charges of amounts "reasonably comparable" to the allowances permitted in interstate pipelines' rates for similar service.

Section 311(a)(2) is the linchpin provision in the NGPA enacted in 1978 to further now well-canvassed efforts of Congress and the Executive Branch to minimize future shortages of natural gas in interstate markets, including the integration of services by interstate pipeline networks with services by separate, but substantial intrastate pipeline transportation systems. *See*

---

[15] The Tenth Circuit's October 17, 1988 opinion in this case obviously predates this Court's opinion in *Duquesne Light Co., et al. v. Barasch, et al.*, —— U.S. —— (No. 87-1160, January 11, 1989). That decision is not decisive as to any questions presented in this Petition because of the errors of the Tenth Circuit.

This case does not involve a state-regulated utility and involves no questions as to statutory or constitutional requirements for inclusion of "costs" of facilities *not* "used and useful" in the intrastate pipeline's service for its interstate customer. The questions raised by the errors below also are *not* limited to impact of inclusion or exclusion of but one or more components of allowable costs or provisions for rate design.

This Court's holdings in *Duquesne* refer to applicable duties of a reviewing court upon challenges of rates as confiscatory and violative of statutory and constitutional requirements, and, in large part, are based upon this Court's earlier opinions in federal rate regulation cases, including opinions in the landmark precedent cases arising under the NGA. These are *the very same decisions* misconstrued and misapplied as to the NGPA by the court of appeals in this case (*e.g., Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591 (1944), and *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968)). See App., 10a-11a n.8, 17a, 19a, 29a.

H.Rep.No. 95-543, 95th Cong., 1st Sess. 45 (1977), *reprinted* in 1978 U.S. Code Cong. & Admin. News 7712.

Congress accorded intrastate pipelines immunity from the pervasive, costly regulation of interstate pipelines under the NGA; precluded pre-emption and federal control of wholly intrastate service; and fashioned new, different substantive rate standards and mandates to the Commission limiting its "discretion." Congress intended thereby to encourage intrastate pipelines to participate, for the first time, as transportation links essential to providing interstate pipelines and others in the interstate market access to intrastate producer sales markets, previously completely closed to all interstate purchasers and free of the burdens of NGA regulation, controls, requirements for rate reporting and other detailed obligations and stringent burdens imposed upon interstate pipelines, under the NGA. (*Ibid.*)

Consistent with Congress' objectives, Section 311 (a) (2) has borne such fruit during the decade since December 1, 1978. While no statistics of totals are available to this Petitioner, Commission orders over the past seven years show that a significant number of intrastate pipelines—both small and large—have entered service for the interstate market under Section 311(a) (2) and undertaken and continue service for interstate carriers and customers, broadening available domestic supply sources for interstate consumers. Many of these intrastate pipelines, like Mustang, are not state-regulated and, therefore, have no choice but to submit petitions to the Commission for rate approval (see citations to some of these Commission orders under Section 311(a) (2) of the NGPA at App. 13a, 21a, 28a, 39a, 46a, 48a, and 61a).

Nevertheless, over the years since December 1, 1978, the Commission has failed to apply Section 311(a) (2) consistently; has waffled in rulings; has published no

clearcut guidelines publicly available to intrastate pipelines; has approved or disapproved components of rate structures inconsistently; has switched from one methodology to another, with both retroactive and prospective application, to reach the desired result of rate reductions; and, finally, in this case, has entered these 1985 and 1986 orders that, contrary to the NGPA directives, (1) preclude recovery of "expenses incurred" and a "reasonable profit"; and (2) require confiscatory refunds that in 1985 and 1986—the years most affected—exceeded the intrastate pipeline's annual collections for its *interstate* service *and* its net income, on an annual basis, from *all interstate* and *intrastate* services (see App., 83a, 92a-93a).

By any rational measure, such orders cannot be found to be "fair" or "equitable," or consistent with Congress' directives, or reconciled with treatment of *interstate* pipelines under the NGA by the Commission and the Courts. Such orders would not be "lawful" and "nonconfiscatory" under statutory and constitutional requirements under the NGA, as construed and applied in the opinions of this Court and courts of appeals, and cited below as controlling for this NGPA section, but then misread and misapplied. However, despite its errors, the Tenth Circuit *was* accurate as to Commission performance since December 1, 1978: after stating that ". . . the 'fair and equitable' standard in Section 311(a)(2) is subject to a variety of interpretations" (App., 10a), the court of appeals said:

> "Unfortunately, however, neither FERC regulations nor adjudications provide a clear, concise statement of the Commission's interpretation of the statute." (App., 12a)

Yet now, the Tenth Circuit's approvals in this case of Commission interpretations and application of Section 311(a)(2), and of the confiscatory end results, stand as controlling precedent for application to rates filed under

Section 311(a)(2) unless this Court intervenes and corrects the errors of the court of appeals. Leaving the court of appeals' opinion standing, without modification, can only repel or retard enticement of intrastate carriers into transactions subject to Commission control, and impair and interfere with more recent, increased Commission efforts to integrate the two markets and foster competitive carriage, compensatory rates, and increased domestic supplies to avoid future shortages. *See, e.g., Associated Gas Distributors v. FERC*, 824 F.2d 981 (D.C. Cir. 1987), *cert. denied*, —— U.S. ——, 108 S.Ct. 1468 (1988).

In addition to the confiscatory impact upon Petitioner, these considerations further fully warrant review by this Court now and an authoritative answer to questions of (1) correctness of the Tenth Circuit's wholesale borrowing and erroneous application of NGA precedent to create interpretations of Section 311(a)(2) standards which are not consistent with Congress' intent in 1978; and (2) the degree of protection for intrastate pipelines from confiscatory rate orders and the ordering of payments of confiscatory refunds. Congress did *not* intend Section 311(a)(2) to be emblazoned with "abandon all hope, ye who enter here," but the Tenth Circuit now has nailed up that sign, to be read by all intrastate transportation pipelines considering transactions subject to Commission-prescribed rates under Section 311(a)(2).

II. Erroneous Interpretations and Applications of Decisions of This Court.

The Tenth Circuit apparently purported to apply (1) principles of statutory construction set out in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), and *Chemical Manufacturers Association v. Natural Resources Defense Council, Inc.*, 470 U.S. 116 (1985) (App., 9a-10a); and (2) standards of

review and tests of rates under the NGA standards and constitutional requirements set out in *FPC v. Hope Natural Gas Company*, 320 U.S. 391 (1944), and *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968) (App., 17a, 19a, 21a, 29a). The court has erred in all respects, by misinterpreting and misapplying this Court's opinions, and these errors undermine each part of the structure of the court of appeal's opinion.

A. As to construction of the NGPA, despite Congress' meticulous efforts to craft entirely different substantive standards (App., 3a-5a), the court of appeals, throughout its opinion simply "borrowed" NGA precedent and the "principles" it derived from NGA cases (App., 17a, 19a, 22a-23a).

Congress wrote plain, *unambiguous* language (*i.e.*, "recovery" of "expenses incurred" and "opportunity" for a "reasonable profit"). Yet, the court of appeals found "ambiguity" in the rate standards of Section 311 (a)(2) where there is none; and then blindly accepted Commission "interpretation," despite the court's own statement that the Commission has never provided industry, customers, or a court with ". . . a clear, concise statement of the Commission's interpretation of the statute" (App., 12a).

The court's path of review of this statutory section thus was not in accord with the steps and principles set out in the *Chevron U.S.A., Inc.* and *Chemical Manufacturers Association* opinions (App., 9a-18a). The ultimate unwarranted, supine "deferential" acceptance of Commission ambiguous, vacillating, shifting "interpretation," therefore, was neither "reasonable," nor in conformance with "stated Congressional policies" at all (App., 18a).

B. As to Commission "application" of Section 311 (a)(2) and substantive statutory and constitutional tests of validity of rate orders, the Tenth Circuit did not, in

fact, apply the cited *Hope* and *Permian* criteria (*cf.* App. 14a, 17a-18a, 22a-24a, 26a-28a, 29a-30a).

Early on, the court mischaracterized Mustang's position as to the rate changes of methodology of costs allocations and rate design, and retroactive application of these changes, as merely a "dispute" over "risk allocation" (App., 14a). Later, the court again erroneously accorded undue and further "deference" to the 1985 and 1986 Commission unveiling of its "apples and oranges" mismatch of "projected volumes" and "actual costs," first announced on June 5, 1985, and then applied retroactively to the rate periods from September 1, 1982 through April 30, 1984 (App., 23a n.18).

On this issue, the court of appeals never recognized the reality that before it was a precise question, now presented here, of the type referred to by this Court, but not presented or decided, in *Duquesne Light Co., et al v. Barasch, et al.*, —— U.S. —— (No. 87-1160, January 11, 1989):

> ". . . a State's decision to arbitrarily switch back and forth between methodologies in a way which required investors to bear the risk of bad investments at some times while denying them the benefit of good investments at others would raise serious constitutional questions" (Slip op., 14-15).

So it is here. Agency orders have shoved upon an intrastate pipeline 100% of the financial impact of El Paso's, and its customers' misjudgments of their markets and errors in their projections between 1982 and 1985, forcing the intrastate pipeline to bear the "risk" of such past, current, or future mistakes by the interstate pipeline and its customers in projecting market demands and transportation requirements. The orders also have been issued and applied to past periods when it is far too late for commensurate changes of unregulated intrastate rates by the intrastate pipeline for these past

periods;[16] strip the intrastate carrier of any minimum volume billing protection, even though the interstate customer contracted to pay such a charge to assure available capacity and to protect *itself* under its own take-or-pay obligations; and the methodologies, however judged and regardless of "theory," produce rate reductions and confiscatory refunds. Neither *Hope* nor *Permian* condones judicial blessing of such "end results" under the NGA. Such aggregate impacts and end results likewise also have no "rational" basis or valid "rationale" under Congress' mandates to the Commission in Section 311 (a) (2) of the NGPA.

The last question before the Tenth Circuit, in addition to questions of lawfulness of "components" or "elements" of the Commission orders, was the question of lawfulness of the aggregate impact, the ultimate "end result", and the culmination of all parts of the orders in the directive for payment of refunds by Mustang to El Paso. (App., 2a, 8a. 29a). The court of appeals did not give this major, controlling question any consideration on the merits, erroneously treating the issue as "foreclosed" by this Court's *Permian* opinion (App., 29a). This is the nadir of misinterpretation of the *Permian* opinion, which did not say what the Tenth Circuit concludes or so remove *Hope* from the viable, vital precedents of this Court in rate regulation.

Thus, on the most vital question before it, which also is most significant under *Hope*, *Permian*, and the Fifth Amendment, the court wrote but two paragraphs. One sets out an inaccurate effort to summarize the issues

---

[16] This impact upon Petitioner was ignored below, but compare that with protection accorded a utility in *Nantahala Power and Light Company v. Thornburg*, 476 U.S. 953, 970-972 (1986), and an interstate pipeline in *Colorado Interstate Gas Company v. FPC*, 324 U.S. 581 (1945) (". . . considerations of fairness, not mere mathematics, govern the allocation of costs", 324 U.S. at 591).

raised by Mustang; and the other sets out a quotation from *Permian* and the court's erroneous conclusion therefrom (see App., 29a, first two paragraphs under heading "IV"). Yet, Mustang's submissions before the Commission showed, despite any quibbling over specific cost components for specific periods, that Mustang had been denied all "opportunity" for recovery of "expenses incurred" and a "reasonable profit" for the two periods from September 1, 1982 (the commencement of the first of the two rate periods involved in this case) through April 30, 1984 (the date prior to effectiveness of the required 1984 annual filing, which was effective May 1, 1984, and is still pending before the Commission).[17]

In sum, the court of appeals simply did not consider or apply the tests of *Hope* or *Permian* to the facts of the case, or examine the very real confiscatory financial impact and confiscatory "end result" of the orders. Yet, as *Duquesne* illustrates, *Permian* did not "foreclose" the inquiry required by the *Hope* test. Therefore, the court of appeals clearly erred, and, most important, leaves as controlling precedent, its conclusion that "the same reasoning applies to fair and equitable rates under Section 311(a)(2)" (App., 29a).

The "end result" thus was never "foreclosed" below, and, for all practical purposes, the court never addressed the question of confiscatory rates and refund orders on the merits. These errors as to *Permian* and *Hope* can be corrected only by this Court. Otherwise, the only controlling judicial precedent for Section 311(a)(2) of the NGPA will stand with a holding that, in effect,

---

[17] Significantly, the Commission itself did recognize that it had ordered refunds estimated to exceed Mustang's gross revenues from service for El Paso and net income from *all* transportation services in 1986 (App., 83a).

says the *Hope* test inquiry does not apply because this Court in *Permian* "foreclosed" that very inquiry under the NGA—a "conclusion" now borrowed and treated as controlling for application of NGPA Section 311(a)(2) rate standards.

III. Courts of Appeals Conflicts.

On two major questions, the conclusions of the Tenth Circuit also cannot be reconciled with decisions of the District of Columbia Circuit.

A. As shown, the Tenth Circuit upheld the Commission as to retroactive application of its new hybrid mixture of "projected volumes" and "actual costs" by applying its own construction of Section 4 of the NGA in *Colorado Interstate Gas Company v. FERC*, 791 F.2d 803 (App., 22a-23a). There, in a case also involving retroactive abrogation of a minimum bill, the Tenth Circuit held that the Commission could enter certain "retroactive" orders under Section 4 of the NGA, citing and relying heavily upon its reading of *City of Batavia v. FERC*, 672 F.2d 64 (D.C. Cir. 1982) (791 F.2d at 807).

On December 13, 1988, the D.C. Circuit reversed the Commission in two similar cases involving Section 4 of the NGA, retroactive orders, minimum bills, related rate components, and interstate pipelines' rate filings under Section 4 of the NGA. *ANR Pipeline Company v. FERC*, —— F.2d —— (Nos. 87-1340, 88-1030, D.C. Cir.), and *East Tennessee Natural Gas Company v. FERC*, —— F.2d —— (No. 87-1765, D.C. Cir. 1988). In *East Tennessee*, the D.C. Circuit discussed its *City of Batavia* opinion extensively, and expressly stated that the Tenth Circuit had misinterpreted that opinion and applied it far too broadly in the same Tenth Circuit *Colorado Interstate* opinion relied upon in this case by the Tenth Cir-

cuit as controlling on the questions of validity of the retroactive impact of the Commission orders.[18]

The impact in law is that there are and will be differing answers in different Circuits when "principles" applicable under Section 4 of the NGA are applied under Section 311(a)(2) of the NGPA to answer the question of Commission power to change retroactively a part of an existing rate structure not placed in issue by a rate filing (such as the minimum volume charge in this case). According to the D.C. Circuit in *East Tennessee*, the Commission can order only a *prospective* change of such a component and cannot order "retrospective" or "retroacitve" changes, but the Tenth Circuit says the opposite.

Also, according to the D.C. Circuit, the Fifth Circuit would agree with the D.C. Circuit but the Third, Tenth, and Eleventh Circuits would not. See *East Tennessee* (slip op., pp. 18-21 and particularly n.15 and n.16 and *Laclede Gas Company v. FERC*, 670 F.2d 38 (5th Cir. 1982)). Here, the Tenth Circuit obviously approved retroactive abrogation of the minimum volume bill provision on the basis of its NGA "precedent" in *Colorado Interstate*, while, in the D.C. Circuit, the Commission would be reversed as to the *retroactive* change, as it just was in the *ANR* and *East Tennessee* cases (and also apparently would be in the Fifth Circuit).

B. The Tenth Circuit's errors in interpretation and application of *Permian* and the failure to perform its duty under the *Hope* precedent (App., 17a, 19a, 29a) also are in conflict with constructions and application of *Hope* and *Permian* in the *en banc* opinion in *Jersey Central Power & Light Company v. FERC*, 810 F.2d 1168 (D.C. Cir. 1987), a case arising under provisions

---

[18] The D.C. Circuit noted that while the Fifth Circuit's construction of Section 4 of the NGA is consistent with its own, the Third and Eleventh Circuit, as well as the Tenth Circuit had misconstrued and misapplied *City of Batavia*.

of the Federal Power Act ("FPA"), then directly comparable to the provisions of the NGA held by the Tenth Circuit to be controlling as to "interpretation" and "application" of Section 311(a)(2) of the NGPA.

In *Jersey Central*, the D.C. Circuit carefully examined what had been done by the Commission as to components of a rate structure; applied and directed meticulous application of "prongs" of the *Hope* and *Permian* tests as to financial impact upon a regulated company, its investors, and its equity owners; and emphasized obligations of both the agency and the courts to examine, with a high degree of care, claims of imposition of confiscatory rates, violative of the Fifth Amendment, by the Commission (810 F.2d at 1175-1188). Here, however, as shown *supra*, the Commission and the court of appeals both simply brushed aside Mustang's showings as to the drastic financial impact upon it of the refund orders; and the court of appeals erred to even greater degree in its erroneous conclusion that this Court, in *Permian*, has "foreclosed" the very meticulous inquiry into allegations of financial and confiscatory impact and "end results" that the D.C. Circuit held, in *Jersey Central*, to be required, under the *Hope* test.

The Tenth Circuit's error can only be compounded by the precedent of its holding that this "foreclosure" reading of *Permian* ". . . applies to fair and equitable rates under Section 311(a)(2)" (App., 29a). Only this Court can now correct this standing, controlling interpretation, which plainly rests upon errors as to this Court's holdings in the NGA cases and which are in conflict with the D.C. Circuit's correct interpretations and applications of the same decisions of this Court.

CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be granted.

Respectfully submitted,

DAVID O. CORDELL
MUSTANG FUEL CORPORATION
1100 First National Center East
Oklahoma City, Oklahoma 73102
(405) 272-9471

CARROLL L. GILLIAM *
RICHARD A. DROM
CATHERINE E. BOCSKOR
GROVE, JASKIEWICZ,
GILLIAM AND COBERT
1730 M Street, N.W.
Washington, D.C. 20036
(202) 296-2900

* Counsel of Record

January 17, 1989

88-1177 (2)

Supreme Court, U.S.
FILED
JAN 17 1989
JOSEPH F. SPANIOL, JR.
CLERK

No. ———

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

———

MUSTANG FUEL CORPORATION (formerly MUSTANG ENERGY CORP.),
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, et al.
Respondent.

———

APPENDICES TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT AND LIST OF PARENT COMPANIES, SUBSIDIARIES, AND AFFILIATES REQUIRED BY RULE 28.1

———

DAVID O. CORDELL
MUSTANG FUEL CORPORATION
1100 First National Center East
Oklahoma City, Oklahoma 73102
(405) 272-9471

CARROLL L. GILLIAM *
RICHARD A. DROM
CATHERINE E. BOCSKOR
GROVE, JASKIEWICZ,
GILLIAM AND COBERT
1730 M Street, N.W.
Suite 501
Washington, D.C. 20036
(202) 296-2900

* Counsel of Record

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

TABLE OF CONTENTS

		Page
APPENDIX A—	Opinion of the United States Court of Appeals for the 10th Circuit in *Mustang Energy Corp. v. Federal Energy Regulatory Commission*, No. 86-2259, 859 F.2d 1447 (10th Cir. 1988)	1a
	Judgment (October 17, 1988)	32a
APPENDIX B—	Order of the Federal Energy Regulatory Commission issued on June 4, 1985, *Order Setting Fair and Equitable Rates, Ordering Refunds, and Denying Motions for Oral Argument* in *Mustang Fuel Corporation*, Docket Nos. ST81-260-000; ST81-260-001, ST81-260-002, and CP82-206-000, 31 F.E.R.C. (CCH) ¶ 61,265 (1985)	34a
APPENDIX C—	Order of the Federal Energy Regulatory Commission issued on July 1, 1986, *Order Rejecting Settlement, Granting in Part and Denying in Part Rehearing and Ordering Refunds* in *Mustang Fuel Corporation*, Docket Nos. ST81-260-006, ST81-260-007, CP82-206-003, and CP82-206-004, 36 F.E.R.C. (CCH) ¶ 61,001 (1986)	63a
APPENDIX D—	Statutory Provisions:	
	Natural Gas Policy Act of 1978, 15 U.S.C. §§ 3301-3432 (1988):	
	§ 311(a), 15 U.S.C. § 3371(a)	94a
APPENDIX E—	Regulations under the Natural Gas Policy Act of 1978:	
	Part 284, Subpart C—Certain Transportation by Intrastate Pipelines, 18 C.F.R. § 284.121, *et seq.*	96a
APPENDIX F—	List of Parent Companies, Subsidiaries, and Affiliates Required by Rule 28.1	104a

APPENDIX A

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

No. 86-2259

MUSTANG ENERGY CORP., formerly known as MUSTANG FUEL,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

EL PASO NATURAL GAS COMPANY,
Intervenor.

APPEAL FROM THE FEDERAL ENERGY REGULATORY COMMISSION

(Docket No. ST81-260)

[Filed Oct. 17, 1988]

David O. Cordell, Mustang Energy Corp., Oklahoma City, Oklahoma, and Carroll L. Gilliam, Grove, Jaskiewicz, Gilliam & Cobert, Washington, D.C. (Craig W. Hulvey and George C. Garikes, Grove, Jaskiewicz, Gilliam & Cobert, Washington, D.C., with them on the briefs), for Petitioner.

Joanne Leveque (Jerome M. Feit, Solicitor, and Catherine C. Cook, General Counsel, with her on the brief),

Federal Energy Regulatory Commission, Washington, D.C., for Respondent.

Before ANDERSON and BALDOCK, Circuit Judges, and PARKER,* District Judge.

ANDERSON, Circuit Judge.

Mustang Energy Corporation ("Mustang") petitions for review under 15 U.S.C. § 3416(a)(4) of orders of the Federal Energy Regulatory Commission ("FERC") establishing "fair and equitable" rates for the transportation of natural gas by Mustang and ordering refunds. We affirm the FERC orders in most respects but modify the orders in part.

I.

Mustang is an intrastate pipeline transporting natural gas in the state of Oklahoma. Prior to 1981, Mustang transported gas from gas producing areas to electrical generating plants for Oklahoma Gas and Electric Company ("OG&E"). In 1981, Mustang entered into a Transportation Agreement with El Paso Natural Gas Company ("El Paso"). The Transportation Agreement primarily relied on excess capacity in Mustang's existing facilities, but also required Mustang to construct a new segment of pipeline, an additional compressor station and certain gathering lines. On September 30, 1981, Mustang began transporting gas on behalf of El Paso pursuant to section 311(a)(2) of the Natural Gas Policy Act of 1978 ("NGPA"). 15 U.S.C. § 3371(a)(2). At issue here is FERC's determination of "fair and equitable" rates for transportation service under the NGPA.

Section 311(a)(2) allows the Commission to authorize an intrastate pipeline to transport natural gas on behalf of an interstate pipeline or local distribution company

---

* Hon. James A. Parker, U.S. District Court, New Mexico, sitting by designation.

without triggering general FERC jurisdiction under the Natural Gas Act. Section 311(a)(2) provides as follows:

> "§ 3371 (a)(2)(A) In general. The Commission may, by rule or order, authorize any intrastate pipeline to transport natural gas on behalf of
>
> (i) any interstate pipeline; and
>
> (ii) any local distribution company served by any interstate pipeline.
>
> (B) Rates and charges.
>
> (i) Maximum fair and equitable price. The rates and charges of any intrastate pipeline with respect to any transportation authorized under subparagraph (A), including any amount computed in accordance with the rule prescribed under clause (ii), shall be fair and equitable and may not exceed an amount which is reasonably comparable to the rates and charges which interstate pipelines would be permitted to charge for providing similar transportation service.
>
> (ii) Commission Rule. The Commission shall, by rule, establish the method for calculating an amount necessary to
>
> (I) reasonably compensate any intrastate pipeline for expenses incurred by the pipeline and associated with the providing of any gathering, treatment, processing, transportation, delivery, or similar service provided by such pipeline in connection with any transportation of natural gas authorized under subparagraph (A); and
>
> (II) provide an opportunity for such pipeline to earn a reasonable profit on such services."

15 U.S.C. § 3371.[1] *See also* 15 U.S.C. § 3431(a)(2)(A)(ii) (transportation authorized under § 3371(a) is not

---

[1] The applicable regulations implementing the "fair and equitable" standard of this statutory provision are found at 18 C.F.R. § 284.123:

"(a) *General Rule.* Rates and charges for transportation of natural gas authorized § 284.122(a) shall be fair and equitable as determined in accordance with paragraph (b) of this section.

(b) *Election of rates.* (1) Subject to the conditions in §§ 284.8 and 284.9 of this chapter, an intrastate pipeline may elect to:

(i) Base its rates upon the methodology used:

(A) In designing rates to recover the cost of gathering, treatment, processing, transportation, delivery or similar service (including storage service) included in one of its then effective firm sales rate schedules for city-gate service on file with the appropriate state regulatory agency; or

(B) In determining the allowance permitted by the appropriate state regulatory agency to be included in a natural gas distributor's rates for city-gate natural gas service; or

(ii) To use the rates contained in one of its then effective transportation rate schedules for intrastate service on file with the appropriate state regulatory agency which the intrastate pipeline determines covers service comparable to service under this subpart.

(2)(i) *If an intrastate pipeline does not choose to make an election under paragraph (b)(1) of this section, it shall apply for Commission approval, by order, of the proposed rates and charges by filing with the Commission the proposed rates and charges, and information showing the proposed rates are fair and equitable . . . . Upon filing the petition for approval, the intrastate pipeline may commence the transportation service and charge and collect the proposed rate, subject to refund.*

(ii) *150 days after the date on which the Commission received an application filed pursuant to paragraph (b)(2)(i) of this section, the rate proposed in the application will be deemed fair and equitable and not in excess of an amount which interstate pipelines would be permitted to charge for providing similar transportation service, unless within the 150 day period, the Commission either extends the time for action, or institutes a proceeding in which all interested parties will be afforded an opportunity for written comments and for the oral presenta-

subject to Natural Gas Act jurisdiction); *Lear Petroleum Corp.*, 42 FERC ¶ 61,015 at 61,043 (1988) (purpose of Section 311(a)).

According to the legislative history of the NGPA, this provision

> "facilitates development of a national natural gas transportation network without subjecting intrastate pipelines, already regulated by State agencies, to [FERC] regulation over the entirety of their operations. Instead, the intrastate pipelines are immunized from State or Federal regulation as common carriers and from [FERC] regulation under the Natural Gas Act. The intrastate pipelines are only subjected to [FERC] regulation under this legislation to the extent the intrastate pipeline is involved in an authorized sale of natural gas to interstate pipelines or an authorized transportation of natural gas on behalf of interstate pipelines."

H. Rep. No. 95-543, 95th Cong. 1st Sess. 45 (1977), *reprinted in* 1978 U.S. Code Cong. & Admin. News 7712.[2]

---

tion of views, data and arguments. In such proceeding, the Commission either will approve the rate or disapprove the rate and order refund, with interest, of any amount which has been determined to be in excess of those shown to be fair and equitable or in excess of the rates and charges which interstate pipelines would be permitted to charge for providing similar transportation service."

18 C.F.R. § 284.123 (emphasis added). Because Mustang's transportation charges were not regulated by any state authority, Mustang filed with FERC under section (b)(2)(i) seeking approval of its proposed rates as fair and equitable. Other regulatory provisions impose reporting requirements on intrastate pipelines seeking to transport natural gas under NGPA § 311(a).

[2] *See generally* Peters, Interstate and Intrastate Pipeline Transportation and Sale of Gas Under Section 311 of the Natural Gas Policy Act of 1978, 2 *J. Energy Law & Pol'y* 143, 153-55 (1982); 1 American Gas Ass'n, *Regulation of the Gas Industry* § 8.04[2] (1987).

This provision was adopted by the Conference Committee, but the conference report provides little additional guidance regarding the "fair and equitable" standard to be applied to transportation charges.[3]

Pursuant to FERC regulations, Mustang filed for approval of a proposed transportation rate of 22.29 cents per Mcf for the first two years of the Transportation Agreement. On May 20, 1982, FERC issued an order authorizing the transportation and approving the proposed rate for a one-year period, and directing Mustang to file an application each year to justify the existing rate or any change in the transportation rate. *Mustang Fuel Corp.*, 19 FERC ¶ 61,168, *clarified on rehearing*, *Mustang Fuel Corp.*, 20 FERC ¶ 61,057 (1982). The Transportation Agreement approved by FERC also included a "minimum bill" provision, whereby El Paso was charged each month for transportation of a "minimum daily quantity" [4] whether or not that volume was actually transported and delivered to El Paso.

---

[3] "The conference agreement also gives the Commission authority to authorize intrastate pipelines to transport natural gas on behalf of any interstate pipeline, and any local distribution company served by any interstate pipeline. The rates and charges for such transportation are required to be fair and equitable, as defined. They may not exceed an amount which is determined by the Commission to be reasonably comparable to the rates and charges which any interstate pipeline would be permitted to charge for providing a similar transportation service. Such a transaction would not affect the exempt status of any party to the transaction under the Natural Gas Act."

H. Conf. Rep. No. 1752, 95th Cong. 2d Sess. 107, *reprinted in* 1978 U.S. Code Cong. & Admin. News 9023.

[4] The minimum daily quantity was 130,000 Mcf through May 22, 1983 and 58,000 Mcf through April 30, 1984. The minimum daily quantity was "equal to the aggregate minimum volumes which El Paso is required to take or pay for under its contracts with OG&E and independent producers. This minimum daily quantity was to be redetermined at least annually on the basis of El Paso's estimated throughput volumes." Brief of Petitioner at 13.

On September 30, 1982, Mustang filed a petition for rate approval seeking to increase the transportation rate to 32.21 cents per Mcf, effective October 1, 1982. Upon filing, the increased rate became effective and Mustang collected that rate from El Paso, subject to refund. On May 23, 1983, Mustang once again filed for a rate increase, seeking approval of a rate of 34.30 cents per Mcf. Again, this increase became effective upon filing, subject to refund. On May 1, 1984, Mustang filed for another change in the transportation rate. The May, 1984 filing, and any subsequent filings by Mustang, are not the subject of this petition. Thus, this court is concerned only with the proper transportation rates for two "locked-in" periods, October 1, 1982 through May 22, 1983, and May 23, 1983 through April 30, 1984. Rates subsequent to April 30, 1984 are not considered here.

Pursuant to its regulations, FERC instituted rate proceedings and convened staff panels to review the Mustang filings. *See, e.g., Mustang Fuel Corp.*, 22 FERC ¶ 61,231 (1983) (order instituting rate proceedings on September 30, 1982 filing). The two proceedings were ultimately consolidated and heard by a FERC staff panel on May 30, 1984. Mustang and the Commission staff were given the "opportunity for oral presentations of data, views, and arguments concerning both proposed rate increases." *Mustang Fuel Corp.*, 31 FERC ¶ 61,265 at 61,527 (1985). FERC ultimately issued an order setting fair and equitable rates on June 4, 1985. That order established a fair and equitable rate for the first period—October 1, 1982 through May 22, 1983—of 28.93 cents per Mcf, and for the second period—May 23, 1983 through April 30, 1984 —of 33.75 cents per Mcf, and ordered Mustang to pay refunds for excess collections. FERC also invalidated the minimum bill provision and ordered Mustang to refund any charges collected for natural gas not actually transported for El Paso.[5] Finally, FERC ordered Mustang to

[5] FERC also invalidated the minimum bill for the period prior to October 1, 1982, and ordered a refund for collections under the

pay interest on the refunded amounts. *Id.* at 61,535. According to Mustang, the refund obligation totals more than $8 million, plus accumulated interest. Brief of Petitioner at 18 n.26.

Mustang urges us to reverse the FERC orders reducing the transportation rate and eliminating the minimum bill provision. Mustang argues (1) that the rates approved by FERC violate the substantive standard of section 311(a)(2), that is, that they are not "fair and equitable"; (2) that elimination of the minimum bill provision also violates the same substantive standard; (3) that the Commission applied an improper methodology to determine the fair and equitable transportation rate, or, in the alternative, improperly applied its own methodology; (4) that the Commission improperly ordered refunds and assessed interest; and (5) that the Commission's procedures denied Mustang due process of law.

Apparently, we are the first court to consider the "fair and equitable" rate standard of section 311(a)(2).[6] Thus

---

minimum bill provision during the first year of the Transportation Agreement. On rehearing, FERC found that the language of its earlier orders could be read as approving the minimum bill provision for that period and it vacated the initial refund order. *Mustang Fuel Corp.*, 36 FERC ¶ 61,001, at 61,004-05 (1986). Thus, Mustang was allowed to collect from El Paso under the minimum bill provision until October 1, 1982.

[6] We previously considered the NGPA, including section 311, in *Oklahoma v. FERC*, 661 F.2d 832 (10th Cir. 1981), *cert. denied*, 457 U.S. 1105 (1982), where we upheld certain provisions of the NGPA against a constitutional challenge. In addition, courts have considered various NGPA regulations promulgated by FERC, including some related to section 311. *See, e.g., Associated Gas Distributors v. FERC*, 824 F.2d 981, 1001-03 (D.C. Cir. 1987) (reviewing FERC regulations), *cert. denied*, 108 S. Ct. 1468 (1988); *Laclede Gas Co. v. FERC*, 722 F.2d 272, 275-76 (5th Cir. 1984) ("rolled-in" pricing of section 311 gas). However, neither the parties nor this court have been able to identify any prior judicial consideration of the "fair and equitable" standard.

our review focuses on two questions: first, has FERC properly interpreted the statutory language; and second, has FERC properly applied the statutory standard in this case?

II.

Our standard of review is necessarily deferential to FERC's interpretation of the statutory language.

> "Our first inquiry is whether 'Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.' *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-43 (1984) (footnote omitted). We will defer when an agency has chosen between alternative possible constructions of an ambiguous statute:
>
> > 'If . . . the court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation. Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.'
>
> *Chevron, U.S.A.*, 467 U.S. at 843 (footnotes omitted). Where the plain words of the statute do not answer a particular question, the agency interpretation must be reasonable, but it need not be the only reasonable interpretation or the interpretation that the reviewing court would adopt. *See, e.g., Chemical Mfrs. Ass'n v. Natural Resources Defense Council, Inc.*, 470 U.S. 116, 125 (1985). A reviewing court will defer to an agency interpretation of an ambiguous statute unless the agency interpretation is con-

> trary to the policies Congress sought to implement in enacting the statute."

Martin Exploration Management Co. v. FERC, 813 F.2d 1059, 1065 (10th Cir. 1987) (citations omitted), *rev'd on other grounds*, 108 S. Ct. 1765 (1988);[7] *cf. South Carolina Public Service Auth. v. FERC*, 850 F.2d 788, 791 (D.C. Cir. 1988); *Puerto Rico Elec. Power Auth. v. FERC*, 848 F.2d 243, 246-47 (D.C. Cir. 1988). For reasons explained below, we find that the "fair and equitable" standard in section 311(a)(2) is subject to a variety of interpretations. Accordingly, we review FERC's interpretation of that language to determine (1) if it is reasonable, and (2) if it is contrary to Congressional policies.

In section 311(a)(2) Congress directed FERC to establish "fair and equitable" rates for intrastate pipelines transporting natural gas in interstate commerce.[8] In

---

[7] Despite this deferential standard of review, in *Martin* this court reversed FERC's interpretation of certain NGPA provisions as "contrary to the clear intent of Congress." *Martin*, 813 F.2d at 1065. On appeal, the Supreme Court reversed our decision and reinstated FERC's interpretation of the statute. *See Martin* 108 S. Ct. at 1768-69.

[8] One commentator has suggested that the "fair and equitable" standard is essentially an empty standard.

> "An incident that occurred during the long and tortuous negotiations that led to the passage of the Natural Gas Policy Act of 1978 . . . helps to illustrate the empty nature of 'do right' standards like 'just and reasonable.' Congress decided that it wanted to authorize sales of natural gas from intrastate pipelines to interstate pipelines, subject to FERC regulation of the price charged for such sales, but the legislature was in hopeless disagreement concerning the standard that FERC should use in regulating the price at which such sales are made. Congress considered and rejected use of the Natural Gas Act's 'just and reasonable' standard, which had been used for similar purposes for the prior four decades. Legislators in favor of generous price regulation objected because of the existence of many court decisions applying the just and rea-

addition, the rates "may not exceed an amount which is reasonably-comparable to the rates and charges which interstate pipelines would be permitted to charge for providing similar transportation service."[9] The statute also imposes two substantive components of the "fair and equitable" standard. First, the rate must "reason-

---

sonable standard in a manner that seemed to permit or require an agency to set prices at artificially low levels. *E.g., The Permian Basin Area Rate Cases,* 390 U.S. 747 (1968) (affirming rates based on average historical costs). Legislators who preferred stringent price regulation objected because of the many other court decisions applying the standard in a manner that appeared to permit inflated prices. *E.g., American Public Gas Ass'n v. FPC,* 567 F.2d 1016 (D.C. Cir.) (affirming rates based on projected future costs), *cert. denied,* 435 U.S. 907 (1977). Because the legislators could not agree on a real standard, and because each objected to some interpretations of the traditional empty standard, they could avoid impasse only by adopting a new empty standard. Thus was born the 'fair and equitable' standard contained in [§ 311 of the Natural Gas Policy Act]."

Pierce, The Role of Constitutional and Political Theory in Administrative Law, 64 *Tex. L. Rev.* 469, 474 n.18 (1985).

We make no comment on Professor Pierce's characterization of the standard apart from noting that the statutory language leaves substantial discretion to FERC in the setting of transportation rates.

[9] According to section 311(a)(1)(B), an interstate pipeline providing similar transportation service would be allowed to charge rates that are "just and reasonable (within the meaning of the Natural Gas Act)." Thus, despite Congress' choice of different words to describe the rate for intrastate pipelines, the statute suggests that the two standards are, at least, "reasonably comparable."

Moreover, the language of this clause—"may not exceed"—suggests that the comparison with interstate rates is to serve as an upward limit on "fair and equitable" rates. *See Mustang Fuel Corp.,* 31 FERC at 61,534. Because the argument here is that the approved rates are too low, we do not have occasion to examine this provision of the statute in detail.

ably compensate any intrastate pipeline for expenses incurred." Second, the rate must "provide an opportunity for such pipeline to earn a reasonable profit on such services." FERC's adjudications under section 311(a)(2) consistently recognize these statutory standards. *See Mustang Fuel Corp.*, 31 FERC at 61,527. Unfortunately, however, neither FERC regulations nor adjudications provide a clear, concise statement of the Commission's interpretation of the statute. FERC commonly discusses the question in general terms, with reference to the statutory language:

> "Section 311(a)(2) of the NGPA requires that a rate charged by an intrastate pipeline for transportation service rendered on behalf of an interstate pipeline or a local distribution company must be 'fair and equitable and may not exceed an amount which is reasonably comparable to the rates and charges which interstate pipelines would be permitted to charge for providing similar transportation service.' A 'fair and equitable' rate is defined in the Statement of Managers for the NGPA as one that reasonably compensates an intrastate pipeline for expenses incurred by the pipeline for providing the service plus an opportunity for the pipeline to earn a reasonable profit."

Mustang Fuel Corp., 19 FERC at 61,318 (footnote omitted). It is clear, however, that the Commission has chosen to implement section 311(a)(2) through traditional cost-of-service ratemaking.

> "Section 311 on its face permits cost-based transportation rates by requiring the Commission to establish a method for calculating an amount necessary to compensate such pipelines for their expenses and to provide an opportunity to earn a reasonable profit. The setting of rates to recover costs and a reasonable profit is consistent with cost-based ratemaking."

Lear Petroleum Corp., 42 FERC ¶ 61,015 at 61,042 (1988) (footnote omitted);[10] *see also Producer's Gas Co.*, 35 FERC ¶ 63,040 at 65,096-98 (1986) (ALJ decision); FERC, "Interim Regulations Implementing the Natural Gas Policy Act of 1978," 43 *Fed. Reg.* 56,448 at 56,523-26 (1978) (preamble to Part 284, Subpart B regulations). References in the Conference Report on the NGPA also indicate Congress intended for FERC to rely on cost-of-service criteria to set fair and equitable rates. *See* H.R. Rep. No. 1752, 95th Cong., 2d Sess. 107-09, *reprinted in* 1978 U.S. Code Cong. & Admin. News 9023-25 (discussing section 311(b)(2) establishing rate for sales of natural gas by intrastate pipelines); *Lear Petroleum*, 42 FERC at 61,042.

Mustang does not argue that "fair and equitable" rates should not be cost-based. To the contrary, Mustang argues that an intrastate pipeline transporting gas under Section 311 *must* recover its costs and that the Commission may not impose a rate which does not actually cover the costs of transportation service. In other words, according to Mustang, FERC may not allow an intrastate pipeline to lose money on a section 311(a)(2) transaction because, if the pipeline loses money it obviously has not been "reasonably compensated" for its expenses or given an "opportunity to earn a reasonable profit." *See* Brief of Petitioner at 27-30; Reply Brief of Petitioner at 17-18.

FERC on the other hand, emphasizes that costs and the opportunity for a profit are to be considered in rate

---

[10] In *Lear Petroleum*, the Commission rejected the pipeline's argument that section 311(a) required FERC to adopt market-based, rather than cost-based, rates.

Under cost-of-service ratemaking, we are told by Mustang, "a unit transportation rate is determined by dividing the total annual (or annualized) cost of providing service (inclusive of a return on the pipeline's investment) by the annual (or annualized) volumes to be transported." Brief of Petitioner at 5 n.5; *see Producer's Gas Co.*, 35 FERC ¶ 63,042, at 65,119 (1986), Means and Cohn, Common Carriage of Natural Gas, 59 *Tulane L. Rev.* 529, 558-60 (1985).

design. That is, according to FERC, a "fair and equitable" rate is one that allows the pipeline to recover costs and make a profit when the volumes of gas considered in setting the rate materialize as the parties to the transportation agreement expect. *See Mustang Fuel Corp.*, 36 FERC ¶ 61,001 at 61,004 (1986).

The difference between the two approaches becomes particularly important when, as here, we review transportation rates retrospectively. For example, the rate which Mustang originally filed with FERC for the October 1, 1982 to September 30, 1983 rate period was based on certain projections of costs and volumes of gas to be transported.[11] Yet the actual volume transported was substantially below that anticipated, and as a result, the unit rate charged for transportation was inadequate to recover Mustang's costs.[12]

The dispute can also be characterized as a question of risk allocation. FERC's position is that the intrastate pipelines should bear the risk of the underutilization of facilities constructed for section 311(a) transportation; if the rate is initially *designed* to recover costs and allow for profit, the intrastate pipeline must bear the risk of financial losses resulting from any variance from design projections. Mustang argues that the intrastate pipeline should be protected (or, more accurately, allowed to protect itself through its contract with the interstate pipeline) from the financial risks of underutilization.

---

[11] We understand that this simplistic explanation glosses over the question of rate base allocation between El Paso and OG&E, but do not feel that this additional complexity would materially change our basic analysis—the review of FERC's statutory interpretation.

[12] Of course, the minimum bill provision was designed to protect Mustang from this possibility. *Mustang Fuel Corp.*, 31 FERC at 61,532. We consider the impact of the minimum bill provision *infra*.

FERC offered a lengthy explanation of its rationale for allocating these risks to Mustang and intrastate pipelines generally in its initial order in this case:

> "The question of who should bear the risk of underutilization must be viewed in the context of our overall approach toward implementation of section 311. Section 311 was intended to:
>
> > save interstate pipelines great expense by avoiding the need to duplicate intrastate pipeline routes in order to obtain natural gas from producing areas presently served only by intrastate pipeline systems . . . [The section] facilitates development of a national natural gas transportation network, without subjecting intrastate pipelines, already regulated by state agencies, to [FERC] regulation over the entirety of their operations. [citing H.R. Rep. No. 543, 95th Cong., 2d Sess. 45 (1977), *reprinted in* 1978 U.S. Code Cong. & Admin. News 7712 (emphasis omitted).]
>
> In implementing section 311 consistent with this intent, the *Commission has repeatedly expressed concern that interstate customers not bear unwarranted risks as a result of an interstate pipeline making transportation arrangements with intrastate pipelines* rather than constructing its own new transportation facilities.
>
> If an interstate pipeline wishes to construct new transportation facilities, it must first obtain certification from the Commission under section 7(c) of the Natural Gas Act that such facilities are in the public convenience and necessity. . . . The Commission can put conditions (e.g., a minimum throughput requirement) on a certificate that impose the risk of underutilization on the pipeline. . . .

> However, if the interstate pipeline contracts with an intrastate pipeline which constructs new facilities to transport on behalf of the interstate pipeline under section 311, the new facilities can be constructed without Commisison review and approval. . . . Given the absence of Commission review of proposed intrastate facilities, *it is particularly important to encourage the intrastate pipeline to make a sound assessment of the need for and economic viability of the facilities.*
>
> To the extent costs of building and operating intrastate facilities are reflected in the transportation rate approved by the Commission and charged to the interstate pipeline, the interstate pipeline in turn can automatically pass through such costs to its customers. Under NGPA section 601(b)(2)(B), any amount that an interstate pipeline pays for section 311 transportation and that does not exceed the transportation component approved by the Commission is deemed just and reasonable under the Natural Gas Act and so includable in the interstate pipeline's rates. Passthrough of such transportation costs to interstate customers is thereby guaranteed.
>
> Under these circumstances, if an intrastate pipeline proposes to build a new facility solely for section 311 transportation and all costs of construction and operation of the facilities will be reflected in the section 311 transportation rate, the incentive for sound, economic assessment of the proposed facility may be reduced. . . . *Thus, in order to discourage the construction of uneconomical transportation facilities under section 311, we have required that transportation rates covering new facilities operated for section 311 transportation place the risk of underutilization on the intrastate pipeline.*"

Mustang Fuel Corp., 31 FERC at 61,530 (emphasis added, footnotes omitted); *see also Lear Petroleum*, 42

FERC at 61,051-54 ("A rate which permits the pipeline to recover the entire cost of building and operating the facility and a reasonable profit regardless of underutilization reduces the pipeline's incentive to make [a sound assessment of the need for the facilities], since the pipeline will make its profit in any event."); *cf. Columbia Gas Trans. Co. v. FERC*, 848 F.2d 250, 252-54 (D.C. Cir. 1988) (discussing allocation of risk in FERC Order No. 436).

We find FERC's rationale persuasive, particularly in light of the Commission's primary objective under the Natural Gas Act "to protect consumers against exploitation at the hands of natural gas companies." *FPC v. Hope Gas Co.*, 320 U.S. 591, 610 (1943); *see Nat'l Ass'n of Regulatory Utility Comm'rs. v. FERC*, 823 F.2d 1377, 1386 (10th Cir. 1987); *see also Martin Exploration* 813 F.2d at 1062-63 (purpose of NGPA). FERC's balancing of its obligation to interstate ratepayers with the duty to intrastate pipelines under section 311(a) is a reasonable and permissible interpretation of the statutory language.[13]

---

[13] This conclusion is also supported by the Supreme Court's consideration of the comparable "just and reasonable" standard imposed on interstate pipelines by section 5(a) of the Natural Gas Act.

> "[The Supreme] Court has often acknowledged that the Commission is not required by the Constitution or the Natural Gas Act to adopt as just and reasonable any particular rate level; rather, courts are without authority to set aside any rate selected by the Commission which is within a 'zone of reasonableness.' *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 585. No other rule would be consonant with the broad responsibilities given to the Commission by Congress; it must be free, within the limitations imposed by pertinent constitutional and statutory commands, to devise methods of regulation capable of equitably reconciling diverse and conflicting interests."

Permian Basin Area Rate Cases, 390 U.S. 747, 767 (1968); *see also id.* at 797; *Mobil Oil Corp. v. FERC*, 417 U.S. 283, 306-09 (1974); *Public Service Co. of New Mexico v. FERC*, 832 F.2d 1201, 1206 (10th Cir. 1987).

Cf. Associated Gas Distributors v. FERC, 824 F.2d 981, 1003 (D.C. Cir. 1987), *cert. denied*, 108 S. Ct. 1468 (1988). In contrast, Mustang offers no evidence that Congress intended section 311(a)(2) to provide any sort of "hold harmless" protection for intrastate pipelines engaging in natural gas transportation or that interstate ratepayers otherwise protected under the Natural Gas Act should bear the financial risks of section 311 transportation agreements. Our reading of the statute and the legislative history indicates that Congress intended that intrastate pipelines should be able to compete in the transportation market without bearing the burden of full regulation by FERC under the Natural Gas Act. Nor do we believe that Congress intended to offer any sort of preferred status or financial guarantees to intrastate pipelines who seek authorization to transport gas under section 311(a)(2). *See id.* at 1042 ("The purpose of § 311—so far as we are able to discern—is not to bestow special benefits on any of the parties on whose behalf it authorizes transportation (*i.e.*, interstate pipelines and intrastate pipelines as well as LDCs), but to reduce the barriers between the interstate and intrastate gas markets.").

In short, FERC's interpretation of the statutory standard is reasonable and conforms to stated Congressional policies. Thus, we will defer to FERC's interpretation of the "fair and equitable" standard and to its allocation of the risks of underutilization in setting transportation rates in this case.

III.

Even though FERC's characterization of the statutory standard is correct there remains the question of whether the Commission has properly applied that standard in this case. As we noted above, the Supreme Court has adopted an extremely deferential standard of review toward agency determinations under the "just and reasonable" standard of the NGA. That same standard of re-

view should apply to the "fair and equitable" standard of section 311(a)(2).

The Supreme Court has "emphasized that Congress has entrusted the regulation of the natural gas industry to the informed judgment of the Commission, and not to the preferences of reviewing courts." *Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968). Accordingly, when reviewing FERC's ratemaking decisions, "[a] presumption of validity therefore attaches to each exercise of the Commission's expertise, and those who would overturn the Commission's judgment undertake 'the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences.'" *Id.* (quoting *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944)); *see Colorado Interstate Gas Co. v. FERC*, 791 F.2d 803, 806-07 (10th Cir. 1986), *cert. denied*, 107 S. Ct. 907 (1987); *Mississippi River Trans. Corp. v. FERC*, 759 F.2d 945, 953 (D.C. Cir. 1985). Moreover, we "are not obliged to examine each detail of the Commission's decision; if the 'total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end.'" *Permian Basin*, 390 U.S. at 767. *See also Mobil Oil Corp. v. FPC*, 417 U.S. 283, 307 (1974); *Cities Service Gas Co. v. FERC*, 627 F.2d 1027, 1030-31 (10th Cir. 1980). The Court did note, however, that a court reviewing a Commission order "must decide whether each of the order's essential elements is supported by substantial evidence." *Permian Basin*, 390 U.S. at 792.[14]

---

[14] The standard of review outlined in *Permian Basin* and adopted for FERC ratemaking decisions here, is consistent with the NGPA, which requires that Commission findings of fact be supported by "substantial evidence," 15 U.S.C. § 3416 (a)(4), and the Administrative Procedures Act, subjecting discretionary decisions to the "arbitrary and capricious" standard. 5 U.S.C. § 706(2)(A); *see Northwest Central Pipeline Corp. v. FERC*, 797 F.2d 918, 920 (10th Cir. 1986). We choose to emphasize the Supreme Court's language here because it is more directly tailored to the question at hand.

In the context of section 311(a)(2) then, we presume that FERC's determination of a fair and equitable rate is valid, the petitioner bears the burden of showing that the approved rate is unfair and inequitable, and the elements of the order must be supported by substantial evidence. Mustang challenges two aspects of FERC's decision: the selection of actual cost data and the elimination of the minimum bill.

In the two rate filings at issue, Mustang based its projected cost of service on the actual expenses of the most recent twelve-month period "adjusted for inflation and other measurable changes," and used those figures to allocate the rate base between El Paso and OG&E. Brief of Petitioner at 14. During the course of the staff panel proceeding, the staff requested that Mustang submit actual cost of service data for the year ending September 30, 1983, and then recommended that the Commission use that data in calculating the fair and equitable rate. The Commission, finding that "Mustang never explained what specific adjustments were made and the basis for any of the adjustments," adopted the actual cost data. *Mustang Fuel Corp.*, 31 FERC at 61,528.

Mustang argues that it is inconsistent to base rates on actual costs and projected volumes[15] and that, in so

---

[15] In a decision not directly challenged by Mustang, the Commission adopted Mustang's initial approach to the volume side of the rate equation, basing the unit transportation rate on the volumes projected by El Paso and OG&E for the respective rate periods. FERC rejected a staff recommendation that the unit rate be based on the volumes projected in the initial May 1, 1981 petition for rate approval. *Mustang Fuel Corp.*, 31 FERC at 61,528. According to FERC, this approach "reflecting each year the currently projected annual volumes for OG&E and El Paso spreads the risk of underutilization of new and existing facilities between Mustang and El Paso." *Id.* at 61,531. Because El Paso was using both new and existing facilities, the Commission adopted a rate methodology which *shared* some of the risk of underutilization between Mustang and El Paso.

doing, FERC has departed from the methodology that it previously approved. Mustang characterizes this action as an impermissible retroactive change in ratemaking methodology.

The Commission, on the other hand, characterizes its decision as a simple choice of data, emphasizing that, in subsequent cases, it may rely on projected cost data if Mustang adequately explains its projections. *See Mustang Fuel Corp.*, 36 FERC at 61,004 & n.8. In this case, after the initial order, Mustang attempted to explain its adjustments to the cost data through a petition for rehearing, but FERC was unpersuaded. On rehearing, the Commission once again expressed a preference for the actual cost data. "Our reason for rejecting Mustang's adjustments was that they were not adequately explained. The Statement by [Mustang] does not alleviate the concerns expressed in our order. . . . Unsupported adjustments cannot be accepted to meet Mustang's burden of proof. Actual cost data is therefore more reliable and probative." *Id.* at 61,003.

Mustang has identified no authority to support its contention that the use of actual cost data is improper. It simply asserts that the Commission dismissed its adjustments "without a foundation or adequate rationale," and that the decision unfairly shifts costs back to Mustang. While we might view the question differently than FERC, the Commission's decision is supportable. A review of FERC rate decisions reveals that the choice of data is often disputed. *See, e.g., Permian Basin*, 390 U.S. at 800-03 (affirms Commission choice of cost data); *Lear Petroleum*, 42 FERC at 61,045 ("it is preferable to rely on the most up-to-date actual data available at the time the record is closed"); *Phenix Transmission Co.*, 32 FERC ¶ 61,096 at 61,263 (1985) (conditioning section 311(a)(2) rate approval on submission of actual data after two years of operating history); *see also* Pierce, *supra* note 8 at 479 (The "zone

of reasonableness" encompasses rates based on "average costs, marginal costs, historical costs, expected future costs, individual company costs, standard costs, national costs, area costs, and a variety of noncost factors.") (footnotes omitted). Because the burden of proof in the ratemaking process rests on the pipeline, we cannot find the Commission's choice of actual cost data unreasonable. Alternatively, if we consider the selection of appropriate data as a finding of fact, we would conclude that the Commission's choice is supported by substantial evidence. *See Yaffe Iron and Metal Co. v. U.S. EPA*, 774 F.2d 1008, 1014 (10th Cir. 1985) (discussing substantial evidence standard).

Nor do we find that FERC's choice of the actual cost data is inappropriate in this proceeding. Even though the Commission accepted projected costs in Mustang's initial filing, we do not view the selection of actual cost data in the later proceeding as a change in methodology or a retroactive allocation of costs. As the Commission noted, the burden remained on Mustang to justify any rate increases. That burden includes demonstrating the validity of the data submitted to support the increase. We note further that the Commission is not bound by any particular formula or methodology in determining rates. "Provided only that they do not together produce arbitrary or unreasonable consequences, the Commission may employ any 'formula or combination of formulas' it wishes, and is free 'to make the pragmatic adjustments which may be called for by particular circumstances.'" *Permian Basin*, 390 U.S. at 800 (quoting in part *FPC v. Natural Gas Pipeline Co.*, 315 U.S. at 586).

Finally, we do not agree that the Commission has engaged in retroactive ratemaking. FERC regulations make clear that unapproved rates are collected subject to a later refund if the filed rates are determined to be in excess of that which is fair and equitable. 18 C.F.R. § 284.123(b)(2)(i); *see supra* note 1. We have approved

this procedure in connection with FERC's approval of rates under section 4 of the Natural Gas Act, and believe the same principles apply here. *See Colorado Interstate Gas*, 791 F.2d at 806-08. The decisions relied upon by Mustang are clearly inapplicable here. *See, e.g., Natural Gas Pipeline Co. v. FERC*, 590 F.2d 664, 668 (7th Cir. 1979) ("Once a rate order has become final, and no longer subject to judicial review, any change in the rate must be made prospectively." Mustang's rates were not final.).

Mustang also argues that, even if the selection of actual cost data was appropriate, FERC has "incorrectly applied its changed methodology." In the rehearing before FERC, Mustang submitted calculations showing the "proper application of the approach." Brief of Petitioner at 27. Central to Mustang's recalculations was the use of *actual* volumes rather than those projected at the beginning of the rate period.[16]

FERC rejected Mustang's revised application of the rate methodology for several reasons. *See Mustang Fuel Corp.*, 36 FERC at 61,003-04. Again, with one exception addressed below, we find FERC's rationale acceptable. At

---

[16] Obviously, there is some initial appeal to Mustang's argument that it is inconsistent to match "actual" costs and "projected" volumes. After much study, we are convinced this is a classic comparison of "apples and oranges" because cost data and volume projections serve different purposes in the ratemaking equation. Normally, because rates are calculated prospectively, regulators use projected cost and volume data. Here, because FERC's review lagged behind Mustang's frequent rate filings, actual cost data was available. Use of that data is not necessarily a change in methodology, but a refinement of the data. In contrast, basing the unit rate on the actual volumes transported would be a substantive change in methodology, as it would guarantee that the intrastate pipeline would fully recover its costs and shift the risk of underutilization to the interstate pipeline and its ratepayers. For a discussion of the role of throughput projections in rate design, see *Producer's Gas Co.*, 35 FERC at 65,119-21 (ALJ decision); *Lear Petroleum Corp.*, 42 FERC at 61,051-57.

the heart of Mustang's complaint is the argument that the coupling of actual costs and projected volumes "forecloses Mustang from recovering its costs of providing service." Brief of Petitioner at 30. We have already held that section 311(a)(2) does not guarantee that intrastate pipelines will recover the costs of transportation service. There is no evidence in the record that Mustang would have been unable to recover its costs if the projected volumes had actually been transported. In other words, the rate was not unfairly *designed.* Thus, we do not find FERC's application of the methodology unfair or inequitable.

While we affirm the Commission's use of actual cost data, however, we cannot approve the selective use of that data. In its petition for rehearing, Mustang submitted actual cost data for May 1, 1983 through April 30, 1984, covering the second "locked-in" rate period. R. Vol. III at 830-32. Yet FERC continued to base the rate for this period on the actual cost data for October 1, 1982 through September 30, 1983. The order on rehearing includes no explanation of this decision. Given FERC's expressed preference for actual cost data as the "best evidence" of costs in this case, it was unreasonable to use actual cost data for a previous period when the data for the same period was in the record. FERC's failure to address this submission on rehearing forces us to conclude that the decision was arbitrary.[17] Accordingly, we

[17] While the order on rehearing discusses certain of the data submitted by Mustang, the cost data for May 1, 1983 to April 30, 1984 (Appendix B of Mustang's submittal) is not considered. We also find that Mustang's submittal of the actual cost data was timely, for Mustang was unaware that the Commission would use actual cost data until the June 4, 1985 order was issued. Thus, it is appropriate to allow Mustang to submit actual cost data for the second period on rehearing. In fact, the Commission implicitly invited this data in the June 4 order. *See Mustang Fuel Corp.*, 31 FERC at 61,535 ("Mustang can address through a petition for rehearing any recommendations by advisory staff that are adopted by the Commission.").

modify FERC's July 1, 1986 order and direct the Commission to reconsider and recalculate the rate for the second period using the actual cost data submitted by Mustang.[18]

Mustang argues most strenuously against FERC's elimination of the minimum bill provision. As previously explained, the minimum bill provision required El Paso to pay for transportation of a minimum daily quantity of gas regardless of whether that much gas was actually transported, and it insured that Mustang would recover its costs under the Transportation Agreement. FERC rejected the minimum bill "because it imposes unwarranted risk on interstate customers by defeating the allocation of underutilization risk that we adopted . . . in selecting a cost allocation and rate determination methodology." *Mustang Fuel Corp.*, 31 FERC at 61,532; *see supra* note 15; *Mustang Fuel Corp.*, 36 FERC at 61,005-07.

Mustang urges us to reinstate the minimum bill provision, arguing (1) that the minimum bill was part of the consideration for the Transportation Agreement; (2) that the minimum bill provision does not defeat the proper allocation of risk between El Paso and Mustang; (3) that elimination of the minimum bill unfairly allocates risks to Mustang; and (4) that elimination of the minimum bill is unfair and discriminatory. We fail to find these arguments persuasive.

Mustang argues that El Paso agreed to the minimum bill in exchange for transportation on a "firm basis" for

---

[18] We recognize that FERC cannot increase the transportation rate above that filed by Mustang on May 23, 1983. According to Mustang's calculations, use of the cost data submitted on rehearing would result in a higher unit rate than was originally filed (38.91 cents vs. 34.30 cents). R. Vol. III at 830. Thus, assuming that these calculations are correct, the effect of our modification is to order FERC to find the filed unit rate "fair and equitable." Our modification regarding the cost data does not affect FERC's decision to eliminate the minimum bill provision, which we affirm.

its gas. The Commission noted, and the Transportation Agreement provides, that El Paso's needs for pipeline capacity are always subordinate to the needs of OG&E. "Thus," according to the Commission, "El Paso's 'protection' is of a limited nature. El Paso only gets to use Mustang's capacity up to the Daily Quantity level when OG&E does not need it. . . . [T]his is insufficient grounds to support a minimum bill." *Id.* at 61,005. We affirm FERC's reasoning and decision. Regardless of how Mustang attempts to characterize the agreement, El Paso's claims on capacity were subordinate to those of OG&E. FERC's rejection of the "consideration" argument was not unreasonable.

Mustang's argument that the minimum bill provision does not defeat FERC's allocation of risk is totally without merit. Under the minimum bill provision, if Mustang transported less than the daily quantity, El Paso paid all of the costs associated with the unused capacity. Mustang's costs were fully recovered whether the projected volumes were actually transported or not.[19] We have already held that section 311(a)(2) allows the Commission to impose the risk of underutilization on the intrastate pipeline. Mustang's argument that the minimum bill provision does not reallocate the risks to El Paso's ratepayers is unavailing.

Mustang also argues that FERC's decision unfairly shifts the risks of underutilization to Mustang because,

---

[19] As FERC notes, the effect of this provision was "particularly egregious" during the October 1, 1982 through May 22, 1983 rate period because the minimum daily quantity for billing purposes exceeded the volumes projected for rate-making purposes. Thus, the minimum bill provision actually guaranteed Mustang a substantial cost over recovery. *Mustang Fuel Corp.*, 31 FERC at 61,532-33. The operation of the minimum bill provision appears "unfair and inequitable" on its face during this period. The fact that this resulted from El Paso's incorrect projections does not excuse Mustang from the burden of filing a fair and equitable rate or the Commission from ordering one.

under the Transportation Agreement, the projected volumes and the minimum daily quantity are controlled by El Paso. Mustang reasons that if El Paso overestimates the capacity needed, Mustang bears the risk of underutilization. As the Commission noted, El Paso makes the initial throughput projections, but "Mustang does not have to accept such projections without question. Absent a minimum bill provision, we believe that Mustang will seek to get as accurate an estimate from El Paso as possible, so that its proposed rate will reflect its actual costs." *Id.* at 61,006. Once again, FERC has offered a reasoned explanation for its decision.

Finally, Mustang claims that FERC's order is "unfair and discriminatory." Mustang argues that FERC's reliance on a "longstanding policy against minimum bills . . . for interruptible intrastate pipeline transportation," *id.*, is misplaced. We find no reason to review the history of FERC's minimum bill policy because its allocation of risk policy was well-established. *See Mustang Fuel Corp.*, 19 FERC at 61,318; *Mustang Fuel Corp.*, 20 FERC at 61,125; *see also Louisiana Resources Co.*, 23 FERC ¶ 61,445 at 61,986 (1983); *Louisiana Intrastate Gas Corp.*, 18 FERC ¶ 61,034 (1982). Mustang was on notice that FERC would not approve an agreement which placed all of the risks of underutilization on the interstate ratepayers. In that sense, FERC's decision is not unfair.

The order is discriminatory, according to Mustang, because FERC approved minimum bills for interstate pipelines during the same period.[20] FERC concedes that

---

[20] This question was addressed in rulemaking subsequent to the initial order in this case. FERC regulations now prohibit any minimum bill provision for interruptible transportation service under section 311. *See* 18 C.F.R. § 284.9(d) (1988) ("A pipeline's rate for any transportation service provided under this section may not include any minimum bill provision, minimum take provision, or any other provision that has the effect of guaranteeing

it has allowed interstate pipelines to impose minimum bills for firm service, but distinguishes those cases from section 311(a)(2) transportation rates:

> "There is a difference, however, in the regulatory oversight we exercise over inter- and intrastate pipelines. Interstate pipelines are required to obtain a certificate of public convenience and necessity under the Natural Gas Act (NGA) before constructing facilities. The Commission can thus ensure that pipelines actually have the supply and markets to justify building such facilities and that existing customers will not be burdened with unused capacity. We do not have the same regulatory authority over intrastate pipelines. In the case of Mustang, even the state commission does not regulate its rates or approve new construction. It is thus imperative that we ensure that the risks of overbuilding and underutilization are not shifted to the interstate market."

Mustang Fuel Corp., 36 FERC at 61,006. FERC also points to prior section 311(a)(2) cases where minimum bills and standby charges have been discovered. *See Tennessee Gas Pipeline Co.*, 32 FERC ¶ 61,086 at 61,227-30 (1985); *J-W Gathering*, 23 FERC ¶ 61,007 (1983); *Transok Pipeline Co.*, 12 FERC ¶ 61,032 (1980).

FERC approval of minimum bills comparable to the one in the Mustang-El Paso Transportation Agreement is rare. Nevertheless, even if FERC has approved such rates for interstate pipelines, the differences in regulatory authority (combined with FERC's approach to allocation of the risk of underutilization) provide a reasoned basis for different treatment of intrastate pipelines

---

revenue."). For a discussion of FERC's recent approach to minimum bills, see Griggs, Restructuring the Natural Gas Industry: Order No. 436 and Other Regulatory Initiatives, 7 *Energy L.J.* 71, 75-79 (1986).

under section 311(a)(2). Elimination of the minimum bill provision is neither unfair nor discriminatory.[21]

IV.

Mustang next attacks FERC's ability to require refunds and impose interest on that portion of the collected rates which has been deemed in excess of a fair and equitable rate. First, Mustang argues that section 311(a)(2) prohibits FERC from ordering refunds where the result is that Mustang is denied recovery of its costs. We already addressed this argument. Section 311 does not guarantee that costs will be recovered. Moreover, FERC regulations in effect when Mustang entered into the agreement with El Paso made it clear that section 311(a)(2) rates were subject to review and refund. 18 C.F.R. 284.123(b)(2)(i); *see supra* note 1.

Mustang also suggests that a refund order which forces it to repay revenues below its actual cost of service is confiscatory and unconstitutional. The Supreme Court has already foreclosed this argument: "[T]he just and reasonable standard of the Natural Gas Act 'coincides' with the applicable constitutional standards, and any rate selected by the Commission from the broad zone of reasonableness permitted by the Act cannot properly be attacked as confiscatory." *Permian Basin*, 390 U.S. at 770 (citation omitted); *see also Mobil Oil Corp.*, 417 U.S. at 316 n.49. The same reasoning applies to fair and equitable rates under section 311(a)(2).

We also find that the statute generally gives FERC the authority to impose refunds. First, such authority is implicit in the direction to fashion "fair and equitable" rates. More explicitly, the NGPA gives FERC the authority to "prescribe, issue, amend, and rescind such rules

---

[21] We also reject Mustang's argument that section 311 requires comparable treatment of interstate and intrastate pipelines and Mustang's undeveloped and unsupported "equal protection" claim.

and orders as it may find necessary or appropriate to carry out its functions under this chapter." 15 U.S.C. § 3411(a). Similar authority in the Natural Gas Act has been interpreted as giving the Commission broad power to fashion equitable remedies, including refunds. *See FPC v. Tennessee Gas Co.*, 371 U.S. 145, 150-53 (1962); *Consolidated Gas Trans. Corp. v. FERC*, 771 F.2d 1536, 1550-51 (D.C. Cir. 1985); *Skelly Oil Co. v. FPC*, 401 F.2d 726, 727 (10th Cir. 1968) (citing *FPC v. Sunray DX Oil Co.*, 391 U.S. 9, 40-47 (1968)); *Lear Petroleum Corp.*, 42 FERC ¶ 61,015 at 61,059 (1988).[22]

Similarly, the courts have held that interest may be charged on refunds as an appropriate "means of preventing unjust enrichment." *Skelly Oil*, 401 F.2d at 729 (quoting *United Gas Improvement Co. v. Callery Properties, Inc.*, 382 U.S. 223, 230 (1965)). FERC regulations require that interest be assessed on these refunds, 18 C.F.R. § 284.2(b), but Mustang argues that the imposition of refunds in this case is inequitable due to the delays in the ultimate disposition of this case, citing *Estate of French v. FERC*, 603 F.2d 1158, 1168 (5th Cir. 1979). In *French* the total delay was nineteen years; the Commission took eight years to determine a just and reasonable rate and another seven years to act on a petition for special relief. *Id.* at 1167. In contrast, the delay between Mustang's initial filing and FERC's ultimate disposition on rehearing was less than four years. Furthermore, the record reveals that at least some portion of the delay was attributable to settlement negotiations between the parties. This delay is unfortunate, and we do not condone it, but it is not so extraordinary as to warrant relief from the interest requirement. *Cf Louisiana Land and Exploration Co. v. FERC*, 788 F.2d 1132, 1138-39 (5th Cir. 1986).

---

[22] We also note that the Transportation Agreement between Mustang and El Paso provided that any charges in excess of a FERC-approved "fair and equitable" rate would be refunded. R. Vol. I at 254.

Finally, Mustang claims that it was denied due process of law by the Commission's procedures. Mustang fails to identify any specific statutory or constitutional requirement that the Commission's procedures violate. We have reviewed the relevant requirements of the NGPA and the APA in this regard and find no due process violation. *See Mustang Fuel Corp.*, 36 FERC at 61,007; *Mustang Fuel Corp.*, 31 FERC at 61,534-35; *Producer's Gas Co.*, 31 FERC ¶ 61,122 (1985). We are not free to impose additional procedural requirements beyond those required by the statutes and the agency. *Vermont Yankee Nuclear Power Corp. v. NRDC*, 435 U.S. 519, 524 (1978).

For the reasons explained above, Mustang's petition for review is DENIED IN PART AND GRANTED IN PART, AND REMANDED.

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

October 17, 1988

Before Honorable Stephen H. Anderson and Honorable Bobby R. Baldock, Circuit Judges and Honorable James A. Parker, District Judge*

No. 86-2259

MUSTANG ENERGY CORP., formerly known as MUSTANG FUEL,

Petitioner,

vs.

FEDERAL ENERGY REGULATORY COMMISSION,

Respondent.

JUDGMENT

This cause came on to be heard on the record on review from the Federal Energy Regulatory Commission and was argued by counsel.

Upon consideration whereof, it is the judgment of this court that the petition for review is denied in part and granted in part. The cause is remanded to the Federal

---

* Of the United States District Court for the District of New Mexico, sitting by designation.

Energy Regulatory Commission for further proceedings consistent with the court's opinion.

/s/ Robert L. Hoecker
ROBERT L. HOECKER
Clerk

A true copy

Teste

ROBERT L. HOECKER
Clerk, U.S. Court of
Appeals, Tenth Circuit

By: /s/ Audrey F. Weigel
Deputy Clerk

APPENDIX B

FEDERAL ENERGY REGULATORY COMMISSION

[¶ 61,265]

MUSTANG FUEL CORPORATION

Docket Nos. ST81-260-000, ST81-260-001,
ST-81-260-002, and CP82-206-000

Order Setting Fair and Equitable Rates, Ordering Refunds, and Denying Motion for Oral Argument

(Issued June 4, 1985)

Before Commissioners: Raymond J. O'Connor, Chairman; Georgiana Sheldon, A. G. Sousa, Oliver G. Richard III and Charles G. Stalon.

This order sets fair and equitable transportation rates for transportation service by Mustang Fuel Corporation (Mustang) for El Paso Natural Gas Company (El Paso) and orders refunds.

I. Background

Mustang, an Oklahoma intrastate pipeline, transports natural gas on behalf of El Paso using both existing and new Mustang facilities.

In 1981 Mustang added a new segment to its existing pipeline system. The segment, approximately 43 miles of 20 inch pipe, connects Mustang's system at the Cogar Compressor Station in Caddo County, Oklahoma with Producer's Gas Company's (PGC) new pipeline in Wachita County, Oklahoma. PGC's new line in turn connects with a new pipeline built by El Paso which connects to El

Paso's system at Panoma, Texas.[1] Mustang's new line was constructed under agreements by El Paso with Mustang and PGC to provide El Paso access to new gas supplies in Oklahoma.[2]

On September 30, 1981, Mustang commenced transporting gas on behalf of El Paso pursuant to section 311(a)(2) of the Natural Gas Policy Act of 1978 (NGPA).[3] The transported gas includes gas purchased by El Paso from Oklahoma Gas and Electric Company and certain producers. Mustang initially performed this transportation under the self-implementing authority of section 284.122(a) of the Commission's regulations, which authorizes such transportation for two years without prior Commission approval.[4] On May 1, 1981, Mustang filed a petition in Docket No. ST81-260-000 seeking approval of a 22.29 cents per Mfc transportation rate for the El Paso service. On February 17, 1982, Mustang filed an application in Docket No. CP82-206-000 seeking authority to extend the transportation on behalf of El Paso for a term of 15 years.

On May 20, 1982, the Commission authorized a 15-year transportation arrangement.[5] That order approved a settlement between Mustang and the Commission Staff (Staff) which set a 22.29 cent transportation rate, required periodic review (at least once a year) of the rate, and imposed for rate purposes an imputed annual throughput of 35,387,500 Mcf at the Cogar Compressor

---

[1] *See El Paso Natural Gas Co.*, 15 FERC ¶ 61,203 (1981); *Producer's Gas Co.*, 18 FERC ¶ 61,142 (1982).

[2] 19 FERC ¶ 61,168 (1982); *See* Transportation Agreement between Mustang Fuel Corporation and El Paso Natural Gas Company, (Transportation Agreement) (filed May 1, 1981 in Docket No. ST81-260-000).

[3] 15 U.S.C. § 3371(a)(2) (1982).

[4] 18 C.F.R. § 284.122(a) (1984).

[5] 19 FERC ¶ 61,168.

Station. The May 20 order was clarified by the July 19, 1982 order on rehearing, which set an annual average daily limit of 130,000 Mcf on the transportation service and denied Mustang's request to amend the May 20 order to permit imposition of a minimum bill.[6]

On September 30, 1982, Mustang filed a petition for rate approval (Docket No. ST81-260-0001) seeking to increase its transportation rate, effective on October 1, 1982, to 32.21 cents per Mcf. The Commission then instituted a Staff Panel proceeding to determine whether the proposed rate was fair and equitable.[7] Similarly, on May 23, 1983, Mustang filed a second petition (Docket No. ST81-260-002) seeking approval of a 34.30 cents per Mcf charge, effective May 23, 1983. This increase also became effective subject to refund, pending a Staff Panel proceeding. We therefore must set rates in this proceeding for two locked-in periods, October 1, 1982-May 22, 1983 in Docket No. ST81-260-001 and May 23, 1983-April 30, 1984 in Docket No. ST81-260-002.[8]

On May 30, 1984, the Staff Panel convened to provide the participants an opportunity for oral presentation of data, views, and arguments concerning both proposed rate increases. Only the Staff and Mustang participated. Briefs were filed on June 29, 1984 and August 3, 1984. The Staff Panel certified the record of the proceeding to the Commission on August 22, 1984.

Finally, on September 7, 1984, Mustang filed a motion requesting oral argument before the Commission.

---

[6] 20 FERC ¶ 61,057 (1982).

[7] 22 FERC ¶ 61,231 (1983).

[8] 25 FERC ¶ 61,094 (1983). Mustang's most recent petitions for rate approval in Docket Nos. ST81-260-003 and ST81-260-004, which increased the transportation rate effective May 1, 1984, and decreased the rate effective May 29, 1984, are outside the scope of this order. *See* 28 FERC ¶ 61,388 (1984) and 29 FERC ¶ 61,120 (1984).

II. Statutory Standard

Section 311(a)(2) of the NGPA provides that the Commission may authorize:

> any intrastate pipeline to transport natural gas on behalf of—
>
> (i) any interstate pipeline; and
>
> (ii) any local distribution company served by any interstate pipeline.
>
> 15 U.S.C. § 3371(a)(2).

Intrastate pipelines transporting under section 311(a)(2) may charge a rate that is "fair and equitable and may not exceed an amount which is reasonably comparable to the rates and charges which interstate pipelines would be permitted to charge for similar transportation service." 15 U.S.C. § 3371(a)(2)(B)(i). Section 311(a)(2)(B)(ii) requires the Commission to establish a method for setting a rate to:

> (I) reasonably compensate any intrastate pipeline for expenses incurred by the pipeline and associated with the providing of any gathering, treatment, processing, transportation, delivery, or similar service provided by such pipeline in connection with any transportation of natural gas authorized under subparagraph (A); and
>
> (II) provide an opportunity for such pipeline to earn a reasonable profit on such service.
>
> 15 U.S.C. § 3371(a)(2)(B)(ii).

III. Discussion

The participants in the Staff Panel proceeding raised several issues, which we address in turn.

A. Commission Jurisdiction Under Section 311 Over Mustang's Rates

Mustang originally claimed to be an intrastate pipeline within the meaning of NGPA section 2(16) authorized to transport gas under section 311, and the Commission so found.[9] In this proceeding, however, Mustang argued for the first time that the primary function of its system is "gathering", rather than transportation. Allegedly, Mustang's operations are therefore beyond the scope of the Commission's jurisdiction under section 311.[10]

In *Farmland Industries, Inc.*,[11] we explained the factors that we consider in determining whether a facility can be classified as a gathering system. While the ultimate test is whether the primary function of the facility is transportation or gathering, the factors considered in applying this test include: (1) the diameter and length of the facility, (2) the location of compressors and processing plants, (3) the extension of the facility beyond the central point of the field, (4) the location of wells along all or part of the facility, and (5) the geographical configuration of the system.

Applying these factors to Mustang, it is clear that gathering is not the primary function of the Mustang system. First, the system maps submitted by Mustang (Exh. JOE-1 and Exh. JOE-2) indicate that Mustang operates an extensive 2,862.35 mile system, much of which consists of relatively large diameter pipe. The system includes 7.67 miles of 26″ pipe, .63 miles of 24″ pipe, 160.12 miles of 20″ pipe, 300.38 miles of 16″ pipe, 439.99 miles of 12″ pipe, and the remainder of pipe with diameters from 2 to 10 inches. Mr. Alan Stacy, President of Mustang

---

[9] 19 FERC at p. 61,317.

[10] Comments of Mustang Fuel on Application of Standards of Section 311(a)(2) of Natural Gas Policy Act and in Support of Applications for Approval of Rates at 37-38 (filed June 29, 1984).

[11] 23 FERC ¶ 61,063 (1983).

Gas Products Company and one of Mustang's witnesses, stated that Exhibit JOE-1, which diagrams mostly lines 6″ or more in diameter, "shows the major facilities and major pipelines" while Exhibit JOE-2, which is more detailed, shows "more the smaller, lateral lines, gathering lines, around the system." Tr. at 43-44. Further, the maps also show that the configuration of the system is a network interconnecting gas supplies, compressor plants, gas processing plants, and market delivery points (many of which are power plants) distributed throughout the system.[12] In short, the record demonstrates that while Mustang has some gathering lines, its system primarily transports gas from supply areas to market areas.[13]

Accordingly, Mustang's system-wide rate for El Paso is within the Commission's jurisdiction under section 311(a)(2).

B. Cost of Service and Rate Base

Mustang based its proposed 32.21 cents per Mcf rate in Docket No. ST81-260-001 and 34.30 cents per Mcf rate in Docket No. ST81-260-002 on projected, system-wide cost of service and average rate base for the twelve month periods ending September 30, 1983 and May 23, 1984 respectively. According to Mustang, each cost of service was based on actual expenses for the most current, available twelve

---

[12] *See also* Tr. at 44-48; and Exh. JOE-3. To support its claim as a "gatherer", Mustang cites *J.W. Gathering Co.*, 23 FERC ¶ 61,007 (1983) (involving a system of 6.5 miles of 4.5 inch lines and 15.4 miles of 12.75 inch lines connecting wells to a treating plant and then to a pipeline) and *Seagull Energy Corp.*, 26 FERC ¶ 61,131 (1984) (involving 7 discrete systems of 2 to 10 inch lines from 2 to 20 miles long). But Mustang's system, described above, is not analogous to the systems in these cases, which the Commission found were primarily for gathering.

[13] *Compare Beacon Gasoline Co.*, 20 FERC ¶ 61,041 (1985) (where system located in supply area, consisting of short and relatively small diameter pipe, and entirely downstream from processing plant was found to be a gathering facility.)

month period, "adjusted for inflation and any known, measurable amounts to reflect the best estimate of expenses" for the rate period, and each rate base reflects actual and projected capital expenditures.[14]

Staff, on the other hand, used Mustang's actual system-wide cost of service and average rate base for the period ending September 30, 1983, the most current twelve-month period for which Mustang provided unadjusted figures. Staff accepted all of the actual amounts claimed by Mustang.[15]

While Mustang asserts that the adjustments it made to actual costs and rate base are valid, Mustang never explained what specific adjustments were made and the basis for any of the adjustments. Further, the rates involved are for locked-in periods ending May 22, 1983 and April 30, 1984, respectively, and Staff used the most recent, actual cost of service and average rate base for twelve months in the record.[16] Under these circumstances, we prefer Staff's approach of using actual figures without adjustment.

C. Cost Allocation and Rate Determination

In addition to providing section 311(a) transportation for El Paso, Mustang serves two intrastate customers, Oklahoma Gas and Electric Company (OG&E) and Public Service Company of Oklahoma, on its system. Consequently, Mustang's system-wide cost of service must be allocated between interstate (El Paso) and intrastate

---

[14] Comments of Mustang at 16; Tr. at 56.

[15] Tr. at 74. *See* Initial Submission of Staff, Appendix A (filed June 29, 1984); and Exh. MEA-5.

[16] While there is an actual cost of service and average rate base for the six months ending March 31, 1984 (Exh. MEA-9), there is no basis for treating these amounts as representative of a full twelve-month period upon which a unit rate can be based.

(OG&E)[17] service and a unit cost per Mcf calculated in order to establish the rate for El Paso.

1. Mustang's and Staff's Positions

Mustang proposed to allocate costs between OG&E and El Paso and calculate a unit cost for each period based upon the transportation volumes currently projected by OG&E and El Paso for the respective period. This approach spreads the risk of underutilization of Mustang's facilities between Mustang and El Paso. In contrast, Staff allocated Mustang's costs and calculated a unit cost based upon the OG&E and El Paso volumes projected in Mustang's initial May 1, 1981 petition for rate approval under section 311(a)(2). Staff's approach imposes much less of the risk of underutilization on El Paso and its customers.

Using the following procedure, Mustang allocated costs for two twelve-month periods, one ending September 30, 1983 (for the proposed 32.21 cent rate) and a second ending May 23, 1984 (for the proposed 34.30 cent rate). First, with respect to rate base items,[18] Mustang directly assigned to OG&E or El Paso items related to facilities that are used exclusively by each customer. The remaining, unassigned rate base (about 78% of total adjusted rate base) was allocated between OG&E and El Paso based upon the transportation volumes that each projected for the twelve-month period. Further, after adding El Paso's allocated portion of rate base to the items directly assigned to El Paso, Mustang calculated the ratio of the El Paso portion of rate base to total rate base and

---

[17] For purposes of allocating costs, Mustang and Staff attributed to OG&E all rate base items and cost of service associated with service provided to both OG&E and Public Service Company of Oklahoma.

[18] These items include Plant in Service, Accumulated Reserves for Depreciation, Cash Working Capital, Prepayments, Materials and Supplies, and Reserve for Deferred Income Taxes.

used the ratio to prorate all cost-of-service items. Considering both assigned and unassigned rate base, Mustang allocated to El Paso 29.22 percent of the rate base and, thus, of the cost of service for the September 30, 1983 period and 21.56 percent for the May 23, 1984 period.[19] Finally, to calculate the unit cost per Mcf, Mustang divided the cost of service allocated to El Paso (except costs associated with Cogar Compressor Station) by the volumes projected by El Paso for the period. Thus, Mustang's cost allocations for the September 30, 1983 and May 23, 1984 periods are based on projected volumes for El Paso and OG&E totalling 174 Bcf (34 Bcf for El Paso alone) and 155 Bcf (21.1 Bcf. for El Paso alone) respectively.[20]

Staff applied a similar procedure but used the volumes which were originally projected in Mustang's May 1, 1981 petition for rate approval. Mustang's initial 22.29 cent rate was based on these projections, covering the period July 1, 1981-June 30, 1982.[21] Instead of allocating unassigned rate base (about 80% of total actual rate base) using the current projections of transportation volumes for the rate periods, Staff used the volumes originally projected for July 1981-June 1982, totalling 176.4 Bcf (33.3 for El Paso alone). As a result, Staff, using actual costs for the twelve months ending September 30, 1983, allocated 26.68 percent of the total rate base and the cost of service to El Paso and the rest to OG&E.[22]

---

[19] Exh. C, Statement of Martin E. Adler at 2-3; and Exh. MEA-1 and Exh. MEA-3.

[20] Exh. MEA-1 at 3 and Exh. MEA-3 at 3. Both Mustang and Staff calculated separately the unit costs for Cogar Compressor Station based on the 35,387,500 Mcf throughput established in the settlement in Docket No. ST81-260-000, *et al.*

[21] Mustang's Petition for Approval of Rates and Charges for Transportation, Exh. C, Schedule No. 1 (filed May 1, 1981 in Docket No. ST81-260-000).

[22] Initial Submission of Staff, Appendix A (filed June 29, 1984).

Staff then calculated the unit rate by dividing the cost of service allocated to El Paso (except Cogar Compressor Station costs) by El Paso's originally projected volume of 33.3 Bcf, rather than the El Paso's currently projected volumes. Staff thereby derived a 28.8 cents per Mcf rate for both the periods.

In short, Mustang and Staff used the same basic procedure to allocate costs and determine the rate. They also agreed that costs associated with the Cogar Compressor Station should be divided by the imputed throughput of 35.39 Bcf to derive that portion of the rate. They disagreed over what volumes should be used in determining the remainder of the system-wide transportation rate for El Paso.

2. Analysis

Under our long-standing policy, interstate customers should not bear unwarranted risk of overbuilding by intrastate pipelines. In evaluating Staff's and Mustang's alternative approaches in light of our policy, we consider that in performing section 311 transportation Mustang uses both existing and new facilities that also serve its intrastate customers. We conclude below that, under these circumstances, Mustang's approach should be adopted.

The major part of the Mustang facilities used for section 311 transportation was constructed before Mustang entered into the Transportation Agreement with El Paso. These existing facilities were built to serve OG&E. They still primarily serve OG&E but are not fully utilized. Some of the excess capacity is now used to transport El Paso's gas to the new Mustang facilities that connect with the PGC system.

Under its Transportation Agreement with El Paso, Mustang constructed certain new facilities. First, Mustang built a new line linking the existing Mustang system to the PGC system. The line is used both to transport

El Paso's gas to PGC and to transport gas from connecting laterals for OG&E. Second, Mustang built the Cogar Compressor Station whose initial purpose was to increase the pressure of El Paso's gas entering PGC's line.[23] Third, certain gathering lines were built to carry El Paso owned gas to the Mustang system.

Under Mustang's approach to calculating a system-wide rate covering both new and existing Mustang facilities, the risk of underutilization is shared between El Paso and Mustang (and its intrastate customers). If OG&E and/or El Paso project lower transportation volumes over a rate period, the rates charged both to OG&E and El Paso for the period can increase. This is because both El Paso's rate and the unit cost allocated to Mustang's intrastate market will reflect the reduced volumes through (i) the allocation of costs based on their respective proportions of Mustang's total transportation volumes and (ii) their respective transportation volumes over which their allocated costs are spread. Take, for example, a period where both OG&E and El Paso project lower volumes but El Paso projects a greater than proportionate reduction. El Paso's rate can increase because its allocated share of costs, although reduced by its smaller proportion of total volumes, is spread over its reduced volumes.[24] At the same time, the unit cost allocated to Mustang's intrastate market can also rise to cover its increased allocation of costs and the reduction in the intrastate volumes over which such costs are spread. Similarly, a greater than proportionate reduction in OG&E's

---

[23] Tr. at 48.

[24] While Mustang's proposed 34.30 cent rate, effective May 23, 1983, reflected a higher total cost of service than Mustang's initial 22.29 cent rate, the rate increase is attributable in part to the more than proportionate decline in El Paso's volumes. *Compare* Exh. MEA-3 at 1 and Mustang's Petition for Approval of Rates, Exh. C, Schedule No. 1.

projected volumes for a rate period can increase El Paso's rate as well as the unit cost for the intrastate market.[25]

In contrast to Mustang's proposal, Staff's approach imposes much more of the risk of underutilization of facilities on intrastate customers. Staff bases its proposed system-wide rate on the volumes projected in Mustang's May 1, 1981 petition for rate approval around the time Mustang's new facilities were constructed. Regardless of changes in the current projections, El Paso's rate continues to reflect El Paso's original proportion of total volumes and of the cost of service and to spread the allocated costs over its originally projected volumes. El Paso is insulated from any increased costs attributable to reduced throughput projections after 1981. Staff thereby imposes on Mustang and its intrastate customers all of the risk that El Paso and/or OG&E will use less capacity than projected for the first year that Mustang performed section 311 transportation.

The question of who should bear the risk of underutilization must be viewed in the context of our overall approach toward implementation of section 311. Section 311 was intended to:

> *save interstate pipelines great expense* by avoiding the need to duplicate intrastate pipeline routes in order to obtain natural gas from producing areas presently served only by intrastate pipeline systems . . . [The section] facilitates development of a national natural gas transportation network, without subjecting intrastate pipelines, already regulated by state agencies, to [FERC] regulation over the entirety of their operations.[26]

---

[25] Mustang's proposed rate increase to 32.21 cents, effective October 1, 1982, reflects in part the more than proportionate decline in OG&E's volumes for the period. *Compare* Exh. MEA-1 at 3 and Mustang's Petition for Approval of Rates, Exh. C, Schedule No. 4.

[26] H.R. Rep. No. 95-543, 95th Cong., 2nd Sess. 45 (1977), *reprinted in* (1978) U.S. Code Cong. & Admin. News at 7712.

In implementing section 311 consistent with this intent, the Commission has repeatedly expressed concern that interstate customers not bear unwarranted risks as a result of an interstate pipeline making transportation arrangements with intrastate pipelines rather than constructing its own new transportation facilities.[27]

If an interstate pipeline wishes to construct new transportation facilities, it must first obtain certification from the Commission under section 7(c) of the Natural Gas Act[28] that such facilities are in the public convenience and necessity. The Commission considers, among other things, the amount of gas available for transportation, the proposed capacity of the facilities, and the availability of alternative transportation facilities. The Commission can put conditions (e.g., a minimum throughput requirement) on a certificate that impose the risk of underutilization on the pipeline.[29] Interstate customers can intervene to participate in the Commission's certification review.

However, if the interstate pipeline contracts with an intrastate pipeline which constructs new facilities to transport on behalf of the interstate pipeline under section 311, the new facilities can be constructed without Commission review and approval. Facilities used solely for section 311 transportation are not subject to Commission certification jurisdiction.[30] Given the absence of Commis-

---

[27] *See Louisiana Interstate Gas Corp.*, 18 FERC ¶ 61,034, at p. 61,050 (1982); *Producers' Gas*, 18 FERC at p. 61,292; and *Red River Pipeline Co.*, 18 FERC ¶ 61,149, at p. 61,310 (1982) (in all three cases the Commission limited the terms of settlement rates to prevent imposition of "unwarranted" risk on interstate customers).

[28] 15 U.S.C. § 717f(c) (1982).

[29] *Tennessee Gas Pipeline Co., a Division of Tenneco Inc. v. F.E.R.C.*, 689 F.2d 212, 216 (D.C. Cir. 1982).

[30] 18 C.F.R. § 284.3(c). In the instant case the intrastate pipeline, Mustang, is a private carrier and also is not subject to state regulation. Tr. at 18.

sion review of proposed intrastate facilities, it is particularly important to encourage the intrastate pipeline to make a sound assessment of the need for and economic viability of the facilities.

To the extent costs of building and operating intrastate facilities are reflected in the transportation rate approved by the Commission and charged to the interstate pipeline, the interstate pipeline in turn can automatically pass through such costs to its customers. Under NGPA section 601(b)(2)(B), any amount that an interstate pipeline pays for section 311 transportation and that does not exceed the transportation component approved by the Commission is deemed just and reasonable under the Natural Gas Act and so includable in the interstate pipeline's rates. Passthrough of such transportation costs to interstate customers is thereby guaranteed.[31]

Under these circumstances, if an intrastate pipeline proposes to build a new facility solely for section 311 transportation and all costs of construction and operation of the facility will be reflected in the section 311 transportation rate, the incentive for sound, economic assessment of the proposed facility may be reduced. Full recovery of costs (including costs attributable to underutilization of the facilities) through the transportation rate guarantees the intrastate pipeline recovery of its costs, including return on equity, regardless of whether the new facility is underutilized. Similarly, the interstate pipeline will automatically pass through, and thereby recover, its costs from interstate customers. Yet these customers had no opportunity to participate in a Commission review of the construction decision. Thus, in order to discourage the construction of uneconomical

---

[31] This contrasts with the passthrough, under NGPA section 601(c)(2), of amounts paid with respect to the purchase of gas. Passthrough of these amounts are guaranteed except if they are excessive due to fraud, abuse, or similar grounds. *See Columbia Gas Transmission Corp.*, 26 FERC ¶ 61,334, at pp. 61,710-61,711 (1984).

transportation facilities under section 311, we have required that transportation rates covering new facilities operated for section 311 transportation place the risk of underutilization on the intrastate pipeline.[32]

In setting rates to properly allocate underutilization risk, our concerns differ with regard to existing vs. new facilities. Mustang's existing facilities were planned and built solely for intrastate service, and at the time of construction, all risk of underutilization was borne by Mustang and/or its intrastate customer. Mustang's evaluation of the economic viability of the facilities and its decision to construct could not have been distorted by any assumption that costs resulting from overbuilding could be passed through to interstate customers. Consequently, we need not be concerned that a sharing by interstate and intrastate customers of underutilization risk relative to existing facilities will encourage construction of uneconomic facilities for section 311 transportation.

Further, permitting interstate customers to bear a portion of the costs of underutilization of existing intrastate facilities will encourage the use of such facilities for section 311 transportation. By transporting for an interstate pipeline, an intrastate pipeline is able to spread the costs of underutilization of its existing system over a larger number of volumes and thereby reduce the

---

[32] *Louisiana Resources Co. and Faustina Pipe Line Co.*, 23 FERC ¶ 61,445, p. 61,986 (1983) (approving one-part commodity rate with stipulated throughput so as to "guarantee" interstate customers do not bear risk of underutilization).

But see Black Warrior Pipeline, Inc. and Rayar Pipeline, Inc., 8 FERC ¶ 61,241 (1979) (where in its first case applying the "fair and equitable" standard under section 311, the Commission approved a demand charge to recover the cost of new facilities). The Commission has not followed *Black Warrior* and has instead approved one-part rates, sometimes with stipulated throughputs. *See Producers' Gas*, 18 FERC at p. 61,292; and *Red River*, 18 FERC at p. 61,310.

burden on its intrastate market. Under these circumstances, sharing underutilization costs will facilitate the integration of intrastate and interstate facilities. This is consistent with Congressional intent [33] that section 311 promote savings by interstate pipelines by facilitating the creation of a national gas transportation system.

Applying this policy to the instant case, we conclude that Mustang's approach to cost allocation and rate determination is preferable to Staff's. Here we are setting a transportation rate that covers new and existing facilities that serve both section 311 and intrastate customers. Although Mustang constructed some new facilities used for section 311 transportation, the new facilities are a relatively small extension of Mustang's existing system and, to a great extent, are used in conjunction with the rest of the system to serve both El Paso and intrastate customers. Reflecting this joint use of Mustang's system, both Mustang and Staff rolled in the new facilities except the Cogar Compressor Station and, in calculating El Paso's rate, allocated to intrastate service over 70 percent of Mustang's system-wide cost of service.

As discussed above, Mustang's approach, reflecting each year the currently projected annual volumes for OG&E and El Paso, spreads the risk of underutilization of new and existing facilities between Mustang and El Paso. Because Mustang and its intrastate customers are served by, and will bear a significant portion of any costs from underutilization of, Mustang's new facilities, Mustang's approach does not remove Mustang's economic incentive to avoid overbuilding transportation facilities. There is not the potential distortion of investment decisions that would result if El Paso's interstate customers had to bear all or most of the costs of underutilization. At the same time, by sharing between Mustang and El Paso the costs attributable to Mustang's existing facilities, Mustang's

---

[33] (1978) U.S. Code Cong. & Admin. News at 7712.

approach provides some incentive for Mustang to continue to perform section 311 transportation.

In contrast, Staff's approach unnecessarily shifts most of the risk of underutilization of new and existing facilities to Mustang and its intrastate customers. Under Staff's approach, all of the risk of a decline in transportation volumes below the levels projected in 1981 are imposed on Mustang. El Paso's rate is calculated on the assumption that Mustang will transport the OG&E and El Paso volumes projected in Mustang's May 1, 1981 petition for rate approval. Mustang and its intrastate customers must bear any increased costs attributable to reduced throughput.

Because Mustang's approach accomplishes in this case both the objective of encouraging construction of only economically viable, section 311 facilities and of encouraging use of existing intrastate facilities for section 311 transportation, we prefer that approach over Staff's proposal. In choosing Mustang's approach, we stress that we are not holding that this is the only appropriate method to be used for setting rates under section 311.

3. Determination of Mustang's Rates

We have found that Mustang's approach should be applied in this case but that Mustang's transportation rates should be based on the actual cost of service and average rate base for the period ending September 30, 1983, rather than the adjusted costs and rate base proposed by Mustang. Appendices A and B of this order contain our derivation of the rates based on these findings. We conclude that the resulting rates, 28.93 cents and 33.75 cents per Mcf, are fair and equitable for the periods ending May 22, 1983 and April 30, 1984 respectively.

4. Approach in Future Mustang Rate Proceedings

In approving the use of Mustang's approach in this proceeding, we note our concern over the treatment of the

Cogar Compressor Station and direct the participants in Mustang's next section 311 rate proceeding to address this concern. In the instant proceeding both Mustang and Staff directly allocated to El Paso the portion of Mustang's rate base that is attributable to the Cogar Compressor Station and, in calculating the unit cost of transporting for El Paso, applied the 35.39 Bcf throughput established by the May 20, 1982 settlement in Docket No. ST81-260-000, *et al.* This separate treatment of the Cogar Compressor Station reflects Mustang's claim that these compressors were constructed in order to deliver El Paso's gas at pipeline pressure into PGC's pipeline system and do not directly benefit OG&E.[34]

Since the construction of the Cogar Compressor Station and the 43 mile line connecting Mustang's system to PGC's system, Mustang has added laterals and other facilities to the 43 mile line.[35] According to Mustang, it "quite recently" began purchasing gas from OG&E along that line.[36] This gas is sometimes used to supply El Paso, displacing El Paso's gas that is located on other parts of Mustang's system and that otherwise would be transported to El Paso through the Cogar Compressor Station. Depending on El Paso's needs at any given time, the flow in the 43 line may be reversed to bring OG&E's gas back to OG&E's electric generating facilities.[37]

Because these recent changes in Mustang's facilities and operations may have altered the function of the Cogar Compressor Station, we are concerned that it may no longer be appropriate to treat the station as solely benefitting El Paso. We therefore direct the participants in Mustang's next section 311 rate proceeding to address

---

[34] 19 FERC at p. 61,319; *see also* Tr. at 48.

[35] *See* Exh. JOE-1.

[36] Tr. at 48.

[37] *Id.* at 49, 54, and 86-87.

whether the Cogar Compressor Station provides system-wide benefit and, along with the 43 mile line, should be allocated between El Paso and Mustang's intrastate customers. The participants should also consider whether, under such circumstances, the separate throughput condition for the Cogar Compressor Station should be continued.

For similar reasons, we are concerned that the gathering lines treated by Mustang in this case as solely benefitting either El Paso or OG&E may now provide system-wide benefit. The participants should address whether the cost of these gathering lines should continue to be directly allocated, for ratemaking purposes, to either El Paso or OG&E.

D. Monthly Minimum Bill

Under its Transportation Agreement with El Paso, Mustang provides transportation service to El Paso on a "firm basis" subject to Mustang's obligations to OG&E. Article IV of the Transportation Agreement establishes a monthly minimum bill. Under the minimum bill Mustang charges El Paso each month for transportation of a minimum daily quantity (130,000 Mcf through May 22, 1983 and 58,000 Mcf through April 30, 1984) whether or not such volumes are actually transported and delivered to El Paso. The minimum daily quantity, which equals "at a minimum" the aggregate minimum quantity that El Paso is required to take or pay for under its purchase contracts with OG&E and certain producers, is subject to annual review and redetermination by mutual agreement.

1. Docket Nos. ST81-260-001 and ST81-260-002

Mustang included the minimum bill provision in its proposed rates of 32.21 cents per Mcf and 34.30 cents per Mcf in Docket Nos. ST81-260-001 and ST81-260-002 respectively. The stated rate was applied to the minimum daily quantity rather than to the actual volumes that

Mustang transported for El Paso. At the hearing before the Staff Panel, Mustang proposed to modify the minimum bill, effective January 1, 1984, to provide El Paso "make-up" rights. Within three years of El Paso making a minimum bill payment, Mustang would transport, at no additional charge, any undelivered volumes for which El Paso paid the transportation rate, provided that El Paso first would take its minimum daily quantity. According to Mustang, the minimum bill provision, as modified, is fair and equitable. Allegedly, the minimum bill covers fixed costs (and only minimal variable costs) and reflects its obligation under the Transportation Agreement to build and maintain sufficient capacity to provide El Paso with "firm" service.

We reject the proposed minimum bill because it imposes unwarranted risk on interstate customers by defeating the allocation of underutilization risk that we adopted above in selecting a cost allocation and rate determination methodology. In establishing the methodology for setting Mustang's rate, we concluded that the risk of underutilization of Mustang's facilities should be shared between Mustang and El Paso. This sharing of underultilization risk provides Mustang some incentive to perform section 311 transportation but to avoid overbuilding section 311 facilities.

However, the minimum bill requires El Paso to pay for transportation of a minimum daily quantity through Mustang's system regardless of whether such quantity is transported. To the extent Mustang transports for El Paso less than the minimum daily quantity, El Paso pays *all* costs associated with the unused transportation capacity, i.e., the capacity represented by the difference between the minimum daily quantity and the amount actually transported. Thus, the underutilization risk that we held should be borne by Mustang is shifted back to El Paso.

The effect of the minimum bill is particularly egregious during the October 1, 1982—May 22, 1983 rate period when the minimum daily quantity would be 130,000 Mcf. The minimum bill requires El Paso to pay the transportation rate for 47.5 Bcf per year (130,000 Mcf per day times 365 days). However, the 28.93 cents per Mcf rate for the period is based on annual El Paso volumes of only 35.39 Bcf for Cogar Compressor Station and 34.02 Bcf for the rest of Mustang's system. Under these circumstances, Mustang is guaranteed revenues which more than cover the cost of service adopted for the rate period and so yield a higher return on equity than that allowed in the cost of service.

The impact of the minimum bill is mitigated somewhat during the May 23, 1983-April 30, 1984 rate period. Mustang and El Paso mutually agreed to reduce the minimum daily quantity to 58,000 Mcf per day or 21.17 Bcf per year. The 33.75 cents per Mcf rate for this period is based on annual El Paso volumes of 21.13 Bcf (except for the Cogar Compressor Station). With a minimum daily quantity about equal to projected volumes, the minimum bill shifts back to El Paso much of the risk of underutilization. El Paso bears all additional costs of unused capacity in Mustang's facilities once El Paso's volumes fall below the projected level.

In light of our policy that interstate customers should not bear unwarranted risk of underutilization of intrastate facilities, we hold that the minimum bill provision proposed by Mustang is not fair and equitable. The fact that Mustang provides "firm" service to El Paso does not alter the rationale, discussed above, for the allocation of underutilization risk that we have adopted. Similarly, Mustang's offer to provide El Paso limited make-up rights does not change our analysis. An unfair and inequitable allocation of underutilization costs results if El Paso is unable to meet the conditions for exercising make-up rights. Consistent with prior cases where we have re-

jected minimum bills under section 311,[38] we will remove the minimum bill from Mustang's proposed rates, effective October 1, 1982 and May 23, 1983, and order refund of minimum bill payments under these rates for undelivered volumes.

2. Docket Nos. ST81-260-000 and CP82-260-000

During the Staff Panel's consideration of Mustang's proposed minimum bill, it has become clear that Mustang also applied the minimum bill provision during September 30, 1981 through September 30, 1982, the period covered by the settlement we approved in Docket No. ST81-260-000, *et al.* As discussed below, such application of the minimum bill is not only contrary to Commission policy but also is not authorized by the settlement. We therefore will order refunds for this rate period.

Mustang's initial petition for rate approval, filed May 1, 1981 in Docket No. ST81-260-000, included the minimum bill provision in Article IV of the Transportation Agreement. Settlement discussions resulted in an offer of settlement by Mustang, which filed an amended transportation agreement on February 17, 1982. The transmittal letter describing the settlement offer did not mention the minimum bill provision or otherwise impose the

---

[38] *See* J.W. Gathering, 23 FERC at pp. 61,021-61,022 (where the Commission found that a proposed charge under section 311 based on a "Minimum Monthly Quantity" shifts the risk of facility underutilization to interstate customers and so is contrary to the public interest); and Louisiana Resources, 23 FERC at p. 61,986 (approval of settlement under section 311(a)(2) because of elimination of minimum bill provision obligating interstate pipeline to "ship-or-pay" for a minimum amount of gas).

To the extent Mustang cites non-section 311 cases and rulemakings concerning the use of minimum bills by *interstate* pipeline, its reliance is misplaced. As discussed above, in contrast to interstate pipelines, we do not have plenary rate and facility jurisdiction over intrastate pipelines. For this reason, we have not permitted the risk of underutilization of intrastate facilities to be shifted to interstate customers through minimum bills.

risk of underutilization on interstate customers. On the contrary, Mustang agreed to protect interstate customers from bearing the risk of underutilization of the Cogar Compressor Station by calculating the unit cost of compression at the station based on an imputed throughput of 35.39 Bcf. However, the amended transportation agreement continued to include the minimum bill provision from the initial rate filing. Mustang simply amended Article IV to change all references to the minimum purchase amount from "Contract Demand" to "Daily Quantity." The May 20, 1982 order approved the settlement and a 22.29 cent per Mcf transportation rate but did not mention the minimum bill provision.

El Paso and Mustang sought rehearing of the May 20, 1982 order. Mustang's request for rehearing contained specific proposed amendments to the May 20 order. In particular, Mustang sought to revise Ordering Paragraph (C) of the order to read:

> (C) Mustang is authorized to charge a fair and equitable rate of *22.29* cents per Mcf *computed and adjusted in accordance with Article IV of* [*the transportation*] *agreement with El Paso*, subject to Paragraphs (D) and (E) herein. (emphasis added).[39]

The July 19, 1982 order rehearing rejected the inclusion on the above-underlined phrase, noting:

> Finally, Mustang objects to Ordering Paragraph (C) which found its proposed *22.29* cents rate to be "fair and equitable." Mustang believes that this rate should reflect the adjustment specified in Article IV of the Transportation Agreement. We do not believe that Article IV substantively alters the level of the *22.29* cents rate and therefore would not believe that a modification of the order is necessary. The effect of this rate is for El Paso to pay *22.29* cents for

---

[39] Application of Mustang Fuel Corporation for Rehearing and Clarification and Modification of Order at 11 (filed June 18, 1982).

> *each Mcf of gas actually delivered* and represents a commodity rate rather than a demand charge. 20 FERC at p. 61,125 (1982) (emphasis added).

The statement in the July 19, 1982 order on rehearing that Article IV has no substantive effect on the rate was incomplete because the minimum bill would affect the quantity of gas to which the rate is applied and so would affect the total amount paid by El Paso. However, the order clearly required that the rate be applied only to the quantity actually delivered.

In short, Mustang sought specific approval of an adjustment to the *22.29* cent rate to include a minimum bill that would permit Mustang to charge El Paso for undelivered volumes, but the Commission expressly denied this adjustment. Mustang did not seek rehearing of the rejection of the minimum bill provision.

Despite our rejection of the minimum bill in Docket No. ST81-260-000, *et al.*, Mustang collected the minimum bill during September 30, 1981 through September 30, 1982 under the settlement. Such collection is not authorized by either the May 20, 1982 order or the July 19, 1982 order on rehearing. Since we have also found above that Mustang's proposed continuation of the minimum bill during October 1, 1982 through April 30, 1984 is not fair and equitable, we will order refunds of Mustang's minimum bill collections for undelivered volumes beginning September 30, 1981 through April 30, 1984.[40]

E. Comparability to Interstate Pipelines

In addition to determining a fair and equitable transportation for Mustang's service of El Paso, the Commis-

---

[40] Under section 2.5 of El Paso's Stipulation and Agreement in Docket No. RP82-23-000, *et al.* (approved in *El Paso Natural Gas Co.*, 23 FERC ¶ 61,365 (1983)), El Paso will credit its Account No. 191 with such refunds and reduce its base rates to reflect these reductions.

sion must also find that the rate does not exceed an amount that is reasonably comparable to the rates which interstate pipelines would be permitted to charge for similar transportation service.

Staff proposed to compare its proposed 28.8 cents per Mcf rate with rates for transportation and gathering charged by Mountain Fuel Supply Company (19.67 cents and 33.7 cents),[41] Panhandle Eastern Pipe Line Company (37 cents),[42] and Colorado Interstate Gas Company (46.08 cents).[43] In response, Mustang argued that the Commission has never applied this prong of the rate standard.[44]

We hold that the rates we have found to be fair and equitable (i.e., 28.93 cents per Mcf in Docket No. ST81-260-001 and 33.75 cents per Mcf in Docket No. ST81-260-002) do not exceed amounts reasonably comparable to rates that interstate pipelines would charge for similar service. The short answer to Mustang's position on the comparability test is that NGPA section 311(a)(2) mandates application of this test in setting a transportation rate. Further, there is no evidence in the record that the rates we have adopted exceed what an interstate pipeline would charge for similar service. On the contrary, these rates fall well within the range of interstate rates in the record. We conclude that the rates adopted in Docket Nos. ST81-260-001 and ST81-260-002 satisfy the comparability test.

IV. Mustang's Motion for Oral Argument

On September 7, 1984, Mustang filed a motion requesting oral argument before the Commission in addition to the opportunity for oral argument already provided be-

---

[41] *Mountain Fuel Supply Co.*, 25 FERC ¶ 61,276 (1983).

[42] *Panhandle Eastern Pipe Line Co.*, 27 FERC ¶ 61,233 (1983).

[43] *Colorado Intrastate Gas Co.*, 22 FERC ¶ 61,330 (1982).

[44] Comments of Mustang at 73-74.

fore the Staff Panel. Both counsel for Mustang and Staff made oral and written presentations to the Staff Panel. Mustang asserts that the opportunity for presentations before the Staff Panel proceeding is not sufficient and does "not comport with either due process or fairness to an applicant in a contested rate proceeding." [45]

In support of its motion Mustang cites section 502 of the NGPA. Section 502(a) provides that the Administrative Procedure Act [46] applies to any rule or order issued under the NGPA having the applicability and effect of a rule. NGPA section 502(b) states:

> To the maximum extent practicable, an opportunity for oral presentation of data, views, and arguments shall be afforded with respect to any proposed rule or order described in subsection (a). 15 U.S.C. § 3412(b).

According to Mustang, an order setting rates for an individual company is a rule and so the Commission must permit oral presentations before issuing the instant order.

While it appears that the instant order is a rule governed by informal rulemaking procedures under section 4 of the APA,[47] Mustang has already been provided an opportunity for oral presentation. In this case, the Commission ordered oral presentations to be made before the Staff Panel. Mustang fails to explain why the presentations must be before the Commission itself in order to satisfy due process and NGPA requirements.

---

[45] Motion of Mustang for Oral Argument at 6 (filed September 7, 1984).

[46] 5 U.S.C. § 551 *et seq.* (1982).

[47] *See Phillips Petroleum Co. v. F.P.C.*, 475 F.2d 842, 851-852 (10th Cir. 1973), *cert. denied*, 414 U.S. 1146 (1973) (holding that rate determinations under section 4 of the Natural Gas Act are rules governed by the informal rulemaking procedures under the APA).

Mustang also claims that it is unfair for "Staff" to both (i) appear, represented by counsel, before the Staff Panel and (ii) preside as the panel and subsequently make recommendations to the Commission. Further, although Mustang had a full opportunity to respond to the opposing positions taken by staff counsel before the Staff Panel, Mustang claims that its "right" to reply to recommendations of the panel to the Commission has been denied. Allegedly, this would be cured by permitting oral argument before the Commission.

We reject Mustang's equating of (i) Staff counsel and technical personnel who took an adversary role in this proceeding (and their immediate supervisors for this case) and (ii) the Staff Panel which acted as an advisor to the Commission. Mustang ignores the fact that the same Commission employees did not function in these two roles.

It is hardly unusual for Commission employees to participate, some as litigators and some as advisors, in a given case. On the contrary, this occurs in virtually every section 4 rate proceeding under the Natural Gas Act.[48] This practice is reflected in Rule 2202 of the Commission's regulations. Rule 2202, which applies to adjudicatory-type proceedings such as section 4 rate cases, requires separation of litigation and advisory functions in such cases.[49] This rule does not apply to nonevidentiary proceedings such as the instant Staff Panel proceeding.[50]

---

[48] 15 U.S.C. § 717c

[49] 18 C.F.R. § 385.2202 ("In any proceeding in which a Commission adjudication is made after hearing, no officer, employee, or agent assigned to work upon the investigation or trial of the proceeding or to assist in the trial thereof in that or any factually related proceeding, shall participate or advise, as to the findings, conclusion or decision, except as a witness or counsel in public proceedings").

[50] We also note that separation of functions is not required by due process, the NGPA, or the Administrative Procedure Act in

However, because some legal and technical staff participated as a party in the proceeding, a separation of functions was maintained as a matter of administrative discretion.

Finally, Mustang provides no legal basis for asserting a right under due process to respond to recommendations by advisory staff (e.g., the Staff Panel) to the Commission, particularly since the APA requires no such right to respond in an informal rulemaking.[51] We also note that Mustang can address through a petition for rehearing any recommendations by advisory staff that are adopted by the Commission.

In summary, Mustang already had an opportunity for oral presentation and to respond to opposing positions taken by Staff counsel and fails to show any statutory or other infirmity with procedures used in this case.[52] Because, in addition, the record (including Mustang's presentation) provides a sufficient basis for resolution of the issues in this proceeding, we deny Mustang's motion for further oral argument.

The Commission finds:

(1) For the periods October 1, 1982—May 22, 1983 and May 23, 1983—April 30, 1984 respectively, transportation rates of 28.93 cents and 33.75 cents per Mcf (with-

---

rulemaking proceedings. *See United Steelworkers of America, AFL-CIO v. Marshall*, 647 F.2d 1189, 1214-1215 (D.C. Cir. 1981), *cert. denied*, 453 U.S. 913 (1981); *American Telephone & Telegraph Co. v. FCC*, 449 F.2d 439, 455 (2d Cir. 1971); *Wilson & Co. v. U.S.*, 335 F.2d 788, 797 (7th Cir. 1964).

[51] 5 U.S.C. § 553; *see Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc.*, 435 U.S. 519, 524 (1977) (holding that due process requirements generally do not exceed minimum APA requirements).

[52] *See Producer's Gas Company*, Docket No. ST83-429-002, *et al.* (May 1, 1985), 31 FERC ¶ 61,122, (holding Staff Panel procedures are consistent with due process).

out any minimum bill or adjustment under Article IV of the Transportation Agreement, as amended) are fair and equitable and do not exceed an amount which is reasonably comparable to the rates and charges which interstate pipelines would be permitted to charge for providing similar transportation service.

(2) Mustang was not authorized in Docket No. ST81-260-000, *et al.*, to adjust the approved *22.29* cents per Mcf rate or to otherwise impose a minimum bill.

The Commission orders:

(A) Mustang shall charge transportation rates of 28.93 cents and 33.75 cents per Mcf for the periods covered by Docket Nos. ST81-260-001 and ST81-260-002 respectively. These rates shall not be adjusted under Article IV of the Transportation Agreement, as amended.

(B) Within 45 days of the issuance of this order, Mustang shall refund the following amounts, plus interest: (i) all amounts collected in excess of the approved rates during October 1, 1982—April 30, 1984 and (ii) all amounts collected from September 30, 1981 through April 30, 1984 for volumes not actually transported on behalf of El Paso. Within 10 days thereafter, Mustang shall file a refund report showing the amounts of refunds and interest paid.

(C) Within 60 days of the issuance of this order, El Paso shall file a refund report indicating the rate adjustments required by section 2.5 of its March 15, 1983 Stipulation and Agreement.

(D) All refunds calculated under Ordering Paragraphs (B) and (C) shall include interest at an amount determined in accordance with 18 C.F.R. § 154.102(c) and § 284.2(b).

(E) Mustang's motion for oral argument is denied.

APPENDIX C

FEDERAL ENERGY REGULATORY COMMISSION

[¶ 61,001]

MUSTANG FUEL CORPORATION

Docket Nos. ST81-260-006, ST81-260-007, CP82-206-003 and CP82-206-004

Order Rejecting Settlement, Granting in Part and Denying in Part Rehearing and Ordering Refunds

(Issued July 1, 1986)

Before Commissioners: Anthony G. Sousa, Acting Chairman; Charles G. Stalon, Charles A. Trabandt and C. M. Naeve.

I. Procedural History

On July 3, 1985, Mustang Fuel Corporation (Mustang) filed for rehearing of the Commission's order issued in these proceedings on June 4, 1985.[1] That order established fair and equitable rates for transportation of natural gas by Mustang on behalf of El Paso Natural Gas Company (El Paso) pursuant to section 311(a) of the Natural Gas Policy Act (NGPA) and ordered refunds of amounts collected in excess of such rates.

Subsequently, on April 11, 1986, Mustang filed an offer of settlement. Oklahoma Gas and Electric Company filed comments in support of the settlement proposal.

Three separate periods are at issue in these proceedings. The first period, hereinafter called Period I; extends from September 30, 1981 through September 30, 1982, and is covered by a Commission approved settlement in Docket Nos. ST81-260-000 and CP82-206-000. The transportation rate approved by the Commission for

[1] 31 FERC ¶ 61,265 (1985).

that period is 22.29 cents per Mcf.[2] The second period, to be called Period II, runs from October 1, 1982 through May 22, 1983. Mustang's filing for that period in Docket No. ST81-260-001 requested a rate increase to 32.21 cents per Mcf. The third period, hereinafter Period III, runs from May 23, 1983, when Mustang filed for a further petition seeking approval of a 34.30 cents per Mcf rate, to April 30, 1984. That petition was filed in Docket No. ST81-260-002.

A Staff Panel was convened on May 30, 1984, to provide participants an opportunity for oral presentation of data, views, and arguments concerning the rate increases in the latter two dockets. Briefs were filed by Mustang and the Commission staff (staff). On September 7, 1984, Mustang filed a motion requesting oral argument before the Commission.

II. Background

Mustang commenced transportation on behalf of El Paso on September 30, 1981, under the self-implementing authority of section 284.122(a) of the Commission's regulations, which authorizes such transportation for two years without prior Commission approval.[3] The gas transported is purchased by El Paso from Oklahoma Gas and Electric Company (OG&E), Mustang's major intrastate transportation customer, as well as certain producers.

A 1981 Transportation Agreement between Mustang and El Paso required Mustang to construct a new seg-

---

[2] *FERC Statutes and Regulations, Regulations Preambles 1982-85* ¶ 30,644.

[3] 18 C.F.R. § 284.122(a) (1985). Section 284.122(a) has been amended by the rulemaking issued October 18, 1985, in Docket No. RM85-1-000, 50 Fed. Reg. 42,495-42,496 [*FERC Statutes and Regulations, Regulations Preambles 1982-85* ¶ 30,665]. However, the changes do not affect the substantive issues in this case.

ment of line, approximately 43 miles in length, connecting Mustang's existing system at the Cogar Compressor Station in Caddo County, Oklahoma, with Producer's Gas Company's (PGC) new pipeline in Wachita County, Oklahoma. The existing facilities were built to serve OG&E but were not fully utilized. The Cogar Compressor Station was built to increase the pressure of El Paso's gas as it entered PGC's line. PGC's new line in turn connects to a new pipeline constructed by El Paso to join El Paso's existing system at Panome, Texas, thereby providing El Paso access to new gas supplies in Oklahoma.

June 4, 1985 Commission order

In our order of June 4, 1985, we ruled on three main issues: the proper method of determining Mustang's costs and rates; the fairness and equitableness of Mustang's minimum bill in Periods II and III; and the Commission's intent in earlier orders respecting Mustang's minimum bill for Period I.

With respect to Mustang's costs and rates, we basically adopted the methodology proposed by Mustang, with one exception. First, we approved the rolling-in of new and old facility costs—except those associated with the Cogar Compression Station—because of the joint use of Mustang's system by both El Paso and Mustang's two intrastate customers, OG&E and Public Service Company of Oklahoma. The Cogar Compression Station costs were allocated separately to El Paso. Our reason for rolling-in these costs was the fact that the new facilities constructed by Mustang to serve El Paso are a relatively small extension of Mustang's existing system and, to a great extent, are used in conjunction with the rest of the system to serve both inter- and intrastate customers. We thus concluded that the new facilities do not result in unwarranted costs being borne by interstate customers.

Next, we adopted Mustang's procedure for allocating the rolled-in costs between inter- and intrastate customers

for Periods II and III, with the one exception noted above. Mustang's procedure was as follows. First, it directly assigned to OG&E or El Paso certain rate base items used extensively by each customer. The remaining unassigned rate base items were allocated between OG&E and El Paso based upon the transportation volumes that each projected for each of the two rate periods. After adding the directly assigned rate base items to the portion of the remaining rate base assigned to El Paso, Mustang calculated the ratio of El Paso's portion of rate base to total rate base and used that ratio to prorate all cost-of-service items.

Where we parted company with Mustang was in choosing the appropriate rate base and cost-of-service. For each of the two dockets, Mustang used its projected, system-wide cost-of-service and average rate base for the twelve-month periods ending September 30, 1983 and May 23, 1984, respectively. Staff applied the same basic method but, for both periods, used Mustang's actual system-wide cost-of-service and average rate base for the period ending September 30, 1983, the most current twelve-month period for which Mustang provided unadjusted figures. Staff accepted all actual amounts claimed by Mustang. In our order of June 4, 1985, we adopted Staff's position with respect to use of actual cost-of-service and average rate base because Mustang did not adequately explain its adjustments.

Finally, to calculate the unit cost per Mcf, Mustang divided the cost-of-service allocated to El Paso (except costs associated with the Cogar Compressor Station) by the volumes projected by El Paso for each of the periods in question. Staff had proposed to use the transportation volumes originally projected for El Paso in Mustang's May 1, 1981 petition for rate approval. The settlement rate approved in Docket No. ST81-260-000, *et al.*, was based on those volumes. However, we adopted Mustang's

projected volumes for each rate period to derive the unit cost per Mcf.

Based on the above-described methodology, we found that the fair and equitable rates for the transportation service provided to El Paso for the two locked-in periods were 28.93 cents and 33.75 cents, respectively.

With respect to the second issue, the Commission rejected the minimum bill found in Article IV of the Transportation Agreement because it imposes unwarranted risks on interstate customers by defeating the allocation of risk adopted by the Commission in selecting a cost allocation and rate determination methodology. The Commission found the effect of the minimum bill to be particularly egregious during Period II when the minimum bill would require El Paso to pay the transportation rate for 47.5 Bcf. The Commission's 28.93 cents per Mcf rate is based on annual volumes of only 35.39 Bcf for the Cogar Compressor Station and 34.02 Bcf for the rest of Mustang's system. The June 4, 1985 order directed Mustang to refund payments made for undelivered volumes.

As to the third issue, the Commission found that application of the minimum bill during Period I was not authorized by the settlement and was specifically disallowed by the Commission's order of May 20, 1982 and July 19, 1982.[4] Refunds for minimum bill payments made in excess of charges for actual deliveries were also ordered.

The Commission also denied Mustang's motion for oral argument on the grounds that it failed to explain why oral presentation must be before the Commission itself in order to satisfy due process and NGPA requirements. Finally, the Commission rejected Mustang's argument that due process was violated because members of our Staff appeared as counsel before the Staff Panel and on

---

[4] 20 FERC ¶ 61,057 (1982).

the Staff Panel. No individual served in a dual capacity. Moreover, the proceedings do not require a separation of functions. The separation of functions rule found in Rule 220 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.220) does not apply to non-evidentiary proceedings such as the instant Staff Panel proceeding.

III. Discussion of Mustang's Rehearing Request

Mustang's petition for rehearing specifies numerous errors as grounds for relief. We will address Mustang's arguments as they relate to to specific findings in the Commission's order.

A. Method Of Determining Costs And Rates

Mustang argues on rehearing that the use of actual cost data with projected volumes is inconsistent, unfairly shifts costs retroactively to OG&E and, as a methodology for future rate cases, guarantees delays so that actual costs for a past period can be obtained. Mustang argues that neither the staff panel nor staff counsel requested additional data to explain the adjustment made by Mustang in arriving at its projected costs. Mustang therefore attaches as Appendix A to its request for rehearing the statement of Martin E. Adler, Assistant Treasurer for Mustang, explaining the adjustments made to its cost-of-service. We note this appendix has been submitted after the close of record date of the staff panel.

Mustang's arguments do not address the basic problem we had with Mustang's data. Our reason for rejecting Mustang's adjustments was that they were not adequately explained. The Statement by Martin E. Adler also does not alleviate the concerns expressed in our order of June 4, 1985. It simply reiterates that operating and administrative expenses were subjected to an inflation factor but does not state the source or basis for such inflation factor. Projected increases in overhead costs are attrib-

uted to an increasing number of employees but no figures are provided. Unsupported adjustments cannot be accepted to meet Mustang's burden of proof. Actual cost data is therefore more reliable and probative. It is true that Mustang was not asked to explain its adjustments by the Staff Panel but, as explained in our June 4, 1985 order, the Panel proceeding is not designed as an adjudicatory forum. There is no cross-examination of witnesses. It simply gives the pipeline and other parties an opportunity to present their data, views, and arguments in support of their respective positions. We then weigh the evidence and base our decision on the data presented. Mustang had the burden of proof regarding its asserted adjustments to the actual costs and, quite simply, failed to support them. We therefore deny rehearing of our June 4, 1985 order, on the issue of using actual, versus adjusted, cost-of-service and rate base figures.

On rehearing, Mustang also presents for the first time a number of appendices allegedly setting forth the "correct" application of the method which Mustang seems to think we intended to adopt but did not quite know how to apply. That method, according to Mustang, would use projected volumes for each period to allocate actual costs for each period between OG&E and El Paso. Then actual throughput in each period would be divided into the costs allocated to El Paso under this method to determine the unit rate. Appendices C, D and E to Mustang's Request for Rehearing set forth the cost-of-service allocated to El Paso under this method, with the corresponding rate per Mcf, for each of the three rate periods in question, assuming no minimum bill payments for volumes not received.

Alternatively, Mustang argues that if the Commission disallows the minimum bill and does not correct its application of the method it allegedly adopted, then the Commission is under a statutory and constitutional obligation to allow Mustang to retain its actual costs for service

to El Paso during the same three periods. Mustang therefore attaches three more appendices (Appendices F, G and H) showing Mustang's actual costs and the actual throughput volumes for each period in question. These appendices, like Appendices A, C, D, and E, have been submitted after the close of record date of the staff panel. While it is not clear from Mustang's explanation, we assume that, in Appendices F, G, and H, the allocation of costs between El Paso and OG&E was done on the basis of actual, as opposed to projected, throughput. We will call Mustang's first method (using our presumed method) Alternative A and Mustang's second option Alternative B. The chart in Appendix A to this rehearing order provides a short-hand summary of the different costs of service and rates devised by Mustang and the cost-of-service and rates used by the Commission.

According to Mustang, the result of using Alternative A would be that Mustang would make refunds for Period II of $3,735,144 but no refunds in Period III because it would have had a revenue deficiency of $236,901. If the Commission refuses to "correct" the methodology allegedly adopted in the June 4, 1985 order, then Mustang argues that it must be allowed to retain at a minimum its actual cost of serving El Paso in each period as set forth in Alternative B.

There are, however, numerous problems with the alternative methodologies proposed by Mustang. Its appendices are essentially factual in nature and should have been submitted to the Staff Panel before the close of record date. They were not, and the Commission need not consider them. However, even if they were timely submitted, we find they are deficient. First, Mustang assumes that we intended, not only to remove the minimum bill for Period I, but also to revisit the issues of cost allocation, cost-of-service and rate determination for that period. This was not our intention. The settlement is

binding on Mustang and on the Commission[5] and, given our disposition of the settlement minimum bill issue, *infra*, we need not address any further Mustang's plethora of rate calculations for Period I.

The second error in Mustang's appendices is that they do not take into consideration Mustang's agreement to use an assumed throughput volume for the Cogar Compressor Station. Instead, Alternatives A and B use actual throughput to allocate the total cost-of-service and derive El Paso's rate. Mustang cannot pick and choose the elements of a rate determination that will most favor it. The minimum throughput was part of the settlement package accepted by the Commission and, until Mustang stops allocating those costs separately[6] to El Paso, it must continue to use those volumes in deriving El Paso's unit rate.

Third, while Mustang's appendices would not result in a revenue increase for each period, they would result in a *rate* increase for each period. This is in violation of a cardinal rule of ratemaking, the rule against retroactive rate increases.[7] We do not interpret section 311(a)(2)(B)(ii) of the NGPA as authorizing the Commission to order reparations to make up for revenues unrecovered as a result of a defective rate design. Under that section, the Commission need only: (a) establish a method for

---

[5] *Texas Gas Transmission Corp. v. F.P.C.*, 441 F.2d 1392 (6th Cir. 1971).

[6] In the order of June 4, 1985, we expressed our concern about cost allocation procedure used for the Cogar Compressor Station and directed the participants in Mustang's next section 311 proceeding to address whether that facility now provides system-wide benefits and should, therefore, be allocated between El Paso and Mustang's intrastate customers.

[7] The rule against retroactive ratemaking is applied in a variety of settings and is not limited to ratemaking under the Natural Gas Act. *See Nader v. FCC*, 520 F.2d 182 (D.C. Cir. 1975) (involving telephone rates), *Payne v. Washington Metropolitan Area Transit Comm'n*, 415 F.2d 901 (D.C. Cir. 1976) (involving bus fares).

calculating an amount necessary to "reasonably" compensate the intrastate pipeline for its cost of providing the transportation sevice, and (b) provide "an opportunity" for such pipeline to earn a reasonable profit on such service.

Fourth, Mustang's Appendices F and G assume that Mustang is entitled to a guaranteed, minimum return on rate base when it is statutorily entitled only to an *opportunity* to earn a reasonable profit on its services. *See* Section 311(a)(2)(B)(ii)(II).

The fifth defect in Mustang's arguments is that they assume a mismatching in our June 4, 1985 order of projected volumes for a future period with actual costs from a past period. Mustang assumes this to be a change in methodology from that used in the ST81-260-000 settlement and postulates that we now propose to let cases "languish" until actual costs can be obtained for locked-in periods. Mustang is mistaken. We did not, *at this juncture*, intend any change in methodology. Rather, we used the best available evidence in the record. Since Mustang did not substantiate the adjustments it made to its projected costs, it was necessary to use actual costs.[8]

In conclusion, we find that Appendices C through H of Mustang's petition are fatally flawed and cannot be used as the basis for deriving Mustang's section 311 rates.

B. Minimum Bill

1. Minimum Bill for Period I

In our order of June 4, 1985, we stated that Mustang's use of a minimum bill during Period I was contrary to

---

[8] This does not mean we are bound to use projected volumes with a projected cost-of-service in all future proceedings simply because we accepted the use of this methodology in Docket No. ST81-260-000. Settlements have no precedential value. 18 C.F.R. § 602(c)(1)(iv). *See also*, Ordering Paragraph (G) of our May 20, 1982 order, 19 FERC at p. 61,319.

Commission policy and not authorized by the settlement. We therefore ordered refunds of any amounts collected for undelivered volumes during that period.

On rehearing, Mustang argues that the Commission's action was erroneous because: (1) the minimum bill was justified on the merits, and (2) such action is based upon an erroneous interpretation of the settlement and the orders issued May 20, 1982, and July 19, 1982. For the policy reasons set forth, *infra*, regarding the allocation of risk, we deny Mustang's rehearing on the first ground. However, a reexamination of the settlement agreement and the Commission's orders leads us to grant rehearing on the second ground. We therefore vacate our refund order as it pertains to the minimum bill issue for Period I.

The first document that we reexamined was the Transportation Agreement entered into by Mustang and El Paso. A plain reading of paragraph (A) (1) of Article IV of the Transportation Agreement filed on May 1, 1981, and incorporated by reference in Mustang's February 17, 1982 settlement offer confirms Mustang's argument that El Paso was required to pay for a minimum monthly amount, regardless of actual deliveries, and that the volume level used to compute the monthly billing was subject to annual renegotiation. Neither the cover letter nor the application for approval of the February 17, 1982 settlement agreement specify that a minimum bill is contemplated. Nor is the word "minimum bill" used anywhere in the Transportation Agreement. Mustang therefore took pains not to draw attention to the fact that its proposed rate of 22.29 cents per Mcf was not to be billed per Mcf delivered but, rather, to be multiplied by a monthly minimum volume. Nonetheless, the fact remains that the Transportation Agreement requires El Paso to pay on a monthly basis the following amount:

> An amount computed by multiplying El Paso's Contract Demand in Mcfd by a unit amount equal to: *22.29* cents per Mcfd,[9] times 365/12, rounded to the nearest one-tenth of a cent.

Next, we reexamined our order of May 20, 1982,[10] titled Order Granting Transportation Authorization. That order finds the proposed settlement reasonable and therefore accepts and approves it. While the order speaks in terms of a 22.29 cents per Mcf rate without reference to the mechanics of Article IV, it does not specifically propose any modification of Mustang's minimum bill provision. However, the order contains a number of ambiguities, which were pointed out by Mustang in its Application For Rehearing And Clarification And Modification, filed June 18, 1982.

In the July 19, 1982 Order On Rehearing, the Commission specifically amended the previous order to grant several of the requested modifications but denied Mustang's requested modifications on two issues, one of which concerned Article IV. Unfortunately, rather than clarifying matters, the Commission's Order On Rehearing appears to have compounded the confusion. With respect to Mustang's request for a modification of Ordering Paragraph (C) to include a reference to the provisions of Article IV, the Commission states:

> We do not believe that Article IV substantively alters the level of the 22.29 cent rate and therefore would not believe that a modification of the order is necessary. The effect of this rate is for El Paso

---

[9] The original Transportation Agreement, dated January 9, 1981, and appended as Exhibit A to Mustang's May 1, 1981 Petition for Approval of Rates and Charges in Docket No. ST81-260-000, uses a figure of 19.35 cents per Mcfd. However, the Agreement specifically contemplates that a revised unit rate will be used based on Mustang's actual anticipated cost-of-service.

[10] *FERC Statutes and Regulations, Regulations Preambles 1982-85* ¶ 30,644.

> to pay 22.29 cents for each Mcf of gas actually delivered and represents a commodity rate rather than a demand charge.

As we stated in our order of June 4, 1985, the first sentence of the above-quoted statement is incomplete. While Article IV does not affect the rate charged per Mcf, it has considerable impact on the level of the monthly bill paid by El Paso.

The second sentence is also incomplete. If the reference to "this rate" is to the rate set forth in Article IV, the discussion obviously reflects a misunderstanding of the workings of Article IV, since El Paso is obligated thereunder to pay 22.29 cents not only for each Mcf actually delivered, but also 22.29 cents for volumes *not* delivered, up to 130,000 Mcf per day. If the reference is to the rate as set forth in Ordering Paragraph (C) of the May 20, 1982 order, the assumption is that Ordering Paragraph (C) modified the settlement. Yet the order of May 20, 1982, does not specifically so state. Did the rehearing order of July 19, 1982, by implication, modify the settlement? On reconsideration, we believe not.

The decisive factor leading us to this conclusion is that in neither the May 20, 1982 order nor the July 19, 1982 order did we order refunds of amounts collected for volumes not actually transported. This, despite the fact that Mustang had commenced deliveries to El Paso under the self-implementing authorization of section 284.122(a) on September 30, 1981, some eight months before our first order finding fair and equitable rates, and had thus been collecting minimum bill rates since that date. The order Instituting Rate Proceedings issued September 28, 1981, specifically tracks the language of section 284.123 (b)(2)(ii) when it states that the Commission "will either approve the transportation rate proceeding or disapprove the rate and order refund[s], with interest, of any amount which has been determined to have been

collected in excess of that permitted by the statutory standard." [11] The word "will" is mandatory, not precatory, and does not appear to make refunds discretionary where a rate is disapproved. Since no such refund order was made, we conclude that the language from the July 19, 1982 order quoted above did not modify the rate set forth in Article IV and that the July 19, 1982 order did not eliminate the minimum bill for Period I. We therefore modify Ordering Paragraph (B) of the June 4, 1985 order to rescind Mustang's refund obligation as it relates to Period I.

2. Minimum Bill for Periods II and III

Mustang requests rehearing of our removal of its minimum bill from its rates for Periods II and III. Mustang states that removal of the minimum bill is unwarranted for four reasons. Those reasons will be considered *seriatim.*

(1) *Consideration*

Mustang argues that the minimum bill was part of the consideration it received for entering into the Transportation Agreement with El Paso and for agreeing to commit its system to "first call" by El Paso. Mustang argues that a primary purpose of the minimum bill was to afford El Paso protection in the form of "firm" transportation equal to the volume of its take-or-pay commitment with producers.

Mustang admits, however, that its commitment of capacity to El Paso is subordinate to its commitment to its intrastate customer OG&E. Thus, El Paso's "protection" is of a limited nature. El Paso only gets to use Mustang's capacity up to the Daily Quantity level when OG&E does not need it. It is true that under Article IV El Paso would not pay for the difference between its shipments and the minimum level, if that difference were

[11] 16 FERC ¶ 61,242, at p. 61,519 (1981).

due to Mustang's inability to transport those volumes. But that would also be the case without a minimum bill. El Paso therefore derives little benefit from this commitment of capacity. We conclude, therefore, that this is insufficient grounds to support a minimum bill.

(2) *Risk*

Mustang's second argument is that removal of the minimum bill shifts all risks to Mustang and leaves none on El Paso, even though El Paso controls the Daily Quantity to be used in calculating the minimum bill. Mustang points out that it makes no sales to El Paso and therefore must accept El Paso's projections of throughput. El Paso could therefore project a throughput of 20,000,000 Mcf, make no use of the system whatsoever, and leave Mustang to absorb its operating costs, states the transporter.

We think Mustang underestimates its own business acumen. While El Paso may well have the initiative in making throughput projections, Mustang does not have to accept such projections without question. Absent a minimum bill provision, we believe that Mustang will seek to get as accurate an estimate from El Paso as possible, so that its proposed rate will reflect its actual costs. Furthermore, Mustang has the protection afforded by our review of its rates. If El Paso's actual call on Mustang's system has fallen short of its projections, resulting in an undercollection of costs, Mustang can file to increase its rates. Our orders of May 20, 1982 and July 19, 1982 require Mustang to file *at least* once a year but do not prohibit it from filing more frequently.

As stated in our order of June 4, 1985, the risk of underutilization of Mustang's facilities must be apportioned fairly between Mustang and the interstate customers of El Paso. A minimum bill imposes unwarranted risks on El Paso and removes any incentive Mustang would have to ensure that additional facility investments will be fully utilized.

(3) *Practical Operation*

Mustang's third argument is that the Commission incorrectly assumes that the operation of the minimum bill always results in the kind of discrepancy between actual and projected throughput that occurred in Period II, during which time El Paso elected not to reduce the Daily Quantity. Mustang asserts that the period of October 1, 1982 through May 22, 1983, is abnormal. Any overrecoveries were due to El Paso's refusal to change its Daily Quantity for over a year and its inadequate attention to actual throughput in relation to its forecasts.

This argument does not persuade us. The fact remains that El Paso *did* overestimate its use of Mustang's system and could do so again. The costs of such miscalculations would not be borne by El Paso's stockholders, as Mustang appears to assume, but by El Paso's ratepayers. Under section 601(b)(2) of the NGPA, any amount paid by El Paso for transportation authorized under section 311(a) is deemed just and reasonable if such amount does not exceed that approved by the Commission. Thus, the Commission could not require El Paso's stockholders to absorb any minimum bill charges incurred by El Paso if the minimum bill is approved by us. The Commission has an obligation to protect interstate customers from unwarranted risks. Mustang is better able to protect itself in arms-length negotiations with El Paso than are consumers who have no say in what estimates El Paso uses.

(a) *Discrimination*

Finally, Mustang alleges that the Commission's action is inequitable and provides for disparate treatment of inter- and intrastate pipelines. Mustang points out that Order No. 380,[12] prohibiting interstate pipelines from collecting gas costs for volumes not actually received by their customers was not promulgated until after the pe-

---

[12] *FERC Statutes and Regulations, Regulations Preambles* ¶ 30,571 (1984).

riod at issue in this case. Moreover, states Mustang, Order No. 380 declined to take action regarding transportation minimum bills.

There is a difference, however, in the regulatory oversight we exercise over inter- and intrastate pipelines. Interstate pipelines are required to obtain a certificate of public convenience and necessity under the Natural Gas Act (NGA) before constructing facilities. The Commission can thus ensure that pipelines actually have the supply and markets to justify building such facilities and that existing customers will not be burdened with unused capacity. We do not have the same regulatory authority over intrastate pipelines. In the case of Mustang, even the state commission does not regulate its rates or approve new construction. It is thus imperative that we ensure that the risks of overbuilding and underutilization are not shifted to the interstate market.

In addition, the Commission has recently issued its transportation rulemaking which specifically addressed transportation minimum bills. Under the new blanket certificates issued under Subpart G of Part 284 of the Commission's Regulations, reservation fees are not permitted for Section 311 interruptible transportation by either inter- or intrastate pipelines. *See* 18 C.F.R. § 284.9 (d).

The Commission's determination in the June 4, 1985 order is, moreover, consistent with its long-standing policy against minimum bills or standby reservation charges for interruptible intrastate pipeline transportation. *See Transok Pipeline Company*, Docket No. ST79-8, 12 FERC ¶ 61,032 (1980); *Panhandle Eastern Pipe Line Company*, Docket No. RP82-59, *Trunkline Gas Company*, Docket No. RP82-60-000, 19 FERC ¶ 61,084 (1982). Mustang's arguments that it is being subjected to disparate treatment must therefore be dismissed.

Conclusion

Finally, a minimum bill such as that found in Article IV of the Transportation Agreement discourages the most efficient use of resources. El Paso may be tempted to forego a cheaper gas supply in favor of transporting volumes through Mustang's system because of the incremental cost of the minimum bill. This is clearly not in the public interest. For all of the above reasons, we deny rehearing on the minimum bill issue as it relates to Periods II and III.

C. Due Process

Mustang challenges the Commission's finding that the procedures adopted in this case satisfy statutory and constitutional requirements for due process of law. Mustang contrasts procedures used in a section 311 case with the process involved in a contested rate proceeding under section 4 of the NGA. The company states that, while it does not dispute the Commission's view of what is required by section 502 of the NGPA and the Administrative Procedure Act (APA), there are times when the courts have imposed extra-statutory procedural requirements where an agency has disregarded minimal principles of procedural fairness. According to Mustang, this is such a case.

Mustang has not raised any arguments that were not already addressed in our previous order. It simply reiterates that by not treating this case as an adjudicatory proceeding, we have violated a separation of functions rule. Yet Mustang does not object to with our statement that our order of June 4, 1985, is a rule governed by the informal rulemaking procedures of section 4 of the APA.[13] Neither due process nor the APA requires a separation of litigation and advisory functions in a rulemaking.[14] Even so, no members of the Commission's staff acted in a dual

---

[13] 5 U.S.C. § 551, *et seq.* (1982).

[14] *American Telephone & Telegraph Co. v. FCC*, 499 F.2d 439 (2nd Cir. 1971).

capacity in this case. Although Mustang was not permitted to cross-examine staff on its position, it was accorded an opportunity to ask questions through the Staff Panel.

Mustang argues that permitting it to petition for rehearing does not give it a right to respond to the internal recommendations of the Staff Panel, unless the Commission "corrects the substantive errors that flow from the procedural defects to date . . ." and accepts its adjustments.[15] This is akin to arguing that a procedure is fair only if one wins. The fact is, Mustang has had an opportunity to respond to opposing views before the Staff Panel, and to those of the Commission in a request for rehearing. This is an advisory rulemaking proceeding throughout and the right to respond to the internal recommendations of staff to the Commission is not a matter of right. Due process, in general, and section 502(a) of the NGPA, in particular, do not give such an extraordinary right. Moreover, though we are not required to consider evidence presented after the record is closed, we acceded to Mustang's request to consider the materials in the appendix attached to its rehearing petition on their merits. We have weighed the arguments and additional data presented by Mustang—as well as the lack thereof—and have granted rehearing or modified our prior order where Mustang has presented convincing arguments in favor of its position. Where we were not presented with convincing arguments and data, we rejected its arguments and denied rehearing. Having examined Mustang's proferred evidence in support of its proposed adjustments to actual data, we conclude that Mustang has still not met its burden of explaining and justifying its adjustments. Due process requires no more on our part at this juncture.

Mustang's allegation that the Commission has turned a prescription of rates for the future into an adjudication

---

[15] Request of Mustang Fuel Corp. for Rehearing at 51, fn. 16.

of past charges does not merit serious consideration. Mustang's rates became effective, subject to refund, the day it filed its rate changes. Even if the Commission had issued an order within a month, there would still have been a "past period" involved. The only reason the rates determined to be fair and equitable in this proceeding will not have any future effect is because Mustang filed another rate change on May 1, 1984. The propriety of those rates is being determined in another proceeding.[16] Those rates are not the subject of this proceeding.

D. Refunds

Mustang argues that refunds are not required because the Commission's order is invalid. For the reasons set forth above respecting Mustang's specifications of error, we reject this argument. Next, Mustang asserts that the amount of refunds ordered by the Commission is unlawful because it is based on an incorrect application of the Commission's methodology. Mustang's contention is predicated on the incorrect assumption that the Commission intended, as a matter of principle, to adopt a methodology involving actual costs and projected volumes. (*See* discussion *supra* of Appendices C, D, and E to the Request for Rehearing.) It also incorrectly assumes that for Period I, we intended to revise the rate agreed upon by settlement.

However, even if Mustang were correct (it is not) and we did indeed intend to use projected volumes for allocation and actual costs and volumes for deriving the unit rate for all three periods, Mustang still overrecovered $3,735,144 during Periods II and III.[17] By Mustang's own admission then, it has overrecovered its actual costs. Refunds are thus clearly required.

Mustang requests that, if refunds of any amounts are ordered, the Commission rescind the requirement for im-

---

[16] *See* 28 FERC ¶ 61,388 (1984) and 29 FERC ¶ 61,120 (1984).

[17] Request for Rehearing at 56.

mediate cash refunds and, in lieu thereof, permit Mustang to pay back such amounts with billing adjustments for El Paso over the period from September 1, 1985 through August 31, 1989. Mustang states that it is advised that this alternative method is not opposed by El Paso.

Section 284.2 of the Commission's regulations [18] does not specify a particular refund procedure, leaving the choice of appropriate methodology to the Commission on a case by case basis. In a recent decision in *Mississippi Fuel Company*, Docket No. ST80-298-005, *et al.*,[19] the Commission considered the issue of whether to permit refunds to be disbursed through installments paid over a 12-month period instead of by a lump-sum payment. In *Mississippi Fuel Company*, we noted that, in the typical section 311 case, we would opt for a lump-sum payment of refund amounts but found special circumstances in that case which warranted a departure from this general rule. Those circumstances included a refund period dating back to 1982 and a refund amount that exceeded the intrastate pipeline's claimed return allowance during any of the annual rate periods at issue.

Similar circumstances appear to be present in this case also. First, the refund at issue covers amounts collected during two rate periods dating back to October 1, 1982. Second, the amount of the refund is likely to be substantial. Mustang claims that the aggregate of refunds and interest ordered in our June 4, 1985 order far exceeds annual collections from El Paso, particularly at current throughput volumes, and exceeds Mustang's net income for all of its services to all its customers. A lump-sum refund, even of a lesser amount, would thus create a hardship for Mustang. However, as in *Mississippi Fuel Company*, we do not believe a crediting arrangement is appropriate. Crediting requires a customer to use the

---

[18] 18 C.F.R. § 284.2.

[19] 32 FERC ¶ 61,496 (1985).

facilities in order to receive any benefit from the "refund." We will therefore permit Mustang to refund the amounts collected in excess of the fair and equitable rate through equal monthly installments beginning 45 days from the date of issuance of this order. However, we believe the four year period requested by Mustang is excessive, notwithstanding that El Paso's customers are protected by receiving interest on unpaid balances until the refund obligation is fully discharged. Spreading the refund over such a long period almost guarantees that the customers who will be buying gas from El Paso in 1989 will not be the same customers who bought the gas transported by Mustang in 1982. Furthermore, since Mustang does not now have to refund monies collected under the minimum bill during Period I, the refund burden is substantially lessened. We will therefore shorten the refund period to two years, beginning 45 days from the date of issuance of this order.[20]

E. Interest

Mustang argues that we are precluded from ordering interest because of the delay involved in deciding this case. We do not accept Mustang's characterization of the thirty-one month delay between Mustang's rate filing on September 30, 1982, and our order of June 4, 1985, as all the fault of this Commission and its staff.[21] In between those two dates, extensive settlement negotiations took place and, when they proved unsuccessful, a Staff Panel was convened. Following the Staff Panel, both Mustang and the staff made written submissions, the last of which was filed August 3, 1984. Given the novel nature of this proceeding and the wealth of issues that needed to be addressed, a ten-month delay issuing an order setting fair and equitable rates is not unreasonable.

---

[20] By notice issued July 17, 1985, the Secretary of the Commission extended the due date for Mustang's refunds under the June 4, 1985 order until 15 days after a final order on rehearing. Our order today provides for a 45-day period.

[21] Request for Rehearing at 58.

Mustang's allegation that staff deliberately delayed proceedings to obtain actual cost data is totally spurious and with no basis in fact. Mustang's attachment to the settlement methodology is understandable but the Commission's refusal to approve such method in successive rate cases does not amount to a violation of the fundamental notions of equity, as the company implies. Interest is within the Commission's discretion to order and where, as here, a company has manifestly overcharged for a section 311 service and obtained—interest free—the use of a customer's money for over three years, a repayment with interest is clearly warranted. Mustang's request for rehearing on this issue is denied.

IV. Discussion of Mustang's Offer of Settlement

A. The Settlement Provisions

Mustang submits that its April 11, 1986, settlement proposal is consistent with the Natural Gas Policy Act.[22] applicable Commission policy, and the public interest, and therefore should be approved by the Commission.[23] In support of this statement, Mustang asserts that the proposed settlement removes longstanding and detrimental financial uncertainty for Mustang, as well as providing substantial refunds and take-or-pay relief for El Paso.[24] Specifically, the major terms of the settlement provide for:

1. Refund by Mustang to El Paso of $3,000,000 inclusive of principal and interest.

---

[22] 15 U.S.C. §§ 3301-3432 (1978).

[23] Motion of Mustang Fuel Corporation For Approval of Offer of Settlement and Settlement Agreement, (hereinafter "Mustang's Settlement"), Docket No. ST81-260-000, *et al.* (filed April 11, 1986) at 7.

[24] *Id.* at pages 8 and 9.

2. Concurrent agreement by El Paso and OG&E (a) to suspend all obligations [25] under the January 9, 1981, Gas Resale Agreement between El Paso and OG&E [26] for the period January 1, 1986, through December 31, 1987, and (b) to extend the primary term of that agreement to December 31, 1995.

3. Concurrent agreement by Mustang and El Paso (a) to suspend their obligations under their January 9, 1981, Gas Transportation Agreement until December 31, 1987, and (b) to negotiate in good faith a best-efforts transportation agreement to cover transportation, during this suspension period, of the quantity of natural gas desired by El Paso.

4. Concurrent agreement by El Paso and OG&E to attempt to reach agreement for the purchase of natural gas by OG&E and the sale of such gas by El Paso on a best efforts basis with the intent to augment OG&E's other supplies at a price near that of the then-concurrent spot market and until such time as OG&E may determine its natural gas requirements are satisfactorily fulfilled, but in no event for a period longer than the extended term of the Gas Resale Agreement.

5. Concurrent agreement by El Paso to take, on a best-efforts basis, OG&E's surplus gas at a price agreeable to OG&E and El Paso.

For the reasons stated below, we shall reject this settlement proposal.

---

[25] This would include El Paso's two-year 24 BCF minimum take requirement.

[26] This agreement provides for El Paso's purchase from OG&E of the natural gas that Mustang transports for El Paso.

B. Comments on the settlement proposal

OG&E was the only participant to file comments on the proposed settlement.[27] OG&E states that it supports the settlement. OG&E and El Paso are signatories to the April 11, 1986 settlement, agreement, filed with the Commission as part of Mustang's motion.

C. Consideration of the merits of Mustang's proposal

All active participants in these proceeding have either supported Mustang's settlement proposal, or have not opposed it.[28] Accordingly, we find the proposal to be uncontested. Under Section 385.602(g)(3)[29] of the Commission's regulations, as a prerequisite to Commission approval, an uncontested settlement must be found to appear fair and reasonable and in the public interest.

Mustang posits several arguments to support its contention that the settlement is in the public interest. Initially, Mustang states that the settlement will resolve the longstanding uncertainty as to Mustang's rates for service to El Paso. This uncertainty, Mustang claims, has had an adverse impact upon its financial status and current and future planning. While the settlement may achieve the certainty of rates desired by Mustang, the instant order will have the same effect.

Secondly, Mustang argues that El Paso and its customers will derive significant benefits from (1) the im-

---

[27] On May 29, 1986, El Paso filed a pleading styled as a motion for expedited consideration of Mustang's settlement proposal. However, El Paso's motion also contains what amounts to late-filed comments in support of the settlement. Pursuant to Rule 602(f)(2), 18 C.F.R. § 385.602(f)(2), comments were due by May 1, 1986. The Commission expects such comments to be properly identified and timely-filed. Accordingly, they have not been considered.

[28] 18 C.F.R. § 385.602(f)(3) provides that those who fail to file comments have waived all objections to an offer of settlement.

[29] 18 C.F.R. § 385.602 (1985) applies to written offers of settlement filed in any proceeding pending before the Commission.

mediate flow-through to El Paso's customers of the stipulated refund of $3,000,000 and (2) the suspension of El Paso's purchase and take obligations to OG&E for two years. A statement prepared by El Paso, included as Appendix C to Mustang's offer of settlement, estimates these combined savings over the two-year suspension period at $15,710,000.

However, the only benefit definitively provided for by the actual terms of the settlement agreement is the stipulated immediate refund of $3.0 million dollars. This figure, which is to be considered inclusive of both principal and interest, is completely unsupported and substantially below the roughly $7.2 million in principal alone due from just the minimum bill unlawful charges. The remaining $12.71 million of El Paso's estimate, described by El Paso as Gas Purchase Savings, is based upon unsubstantiated and speculative figures. To calculate these hypothetical savings, El Paso multiplied its contractual two-year minimum take obligation (from OG&E) of 24 BCF by the contract price of $2.72. The resulting product ($65.28 million) was listed as El Paso's Total Purchase Obligation in the event the settlement agreement was not approved. Then El Paso subtracted from this total Purchase Obligation the purported purchase gas costs for the same two-year period from alternative suppliers. These purported lower purchase gas costs were derived by multiplying El Paso's weighted average cost of gas (WACOG) from its April 1, 1986 PGA by its contractual two-year minimum take obligation of 24 BCF. The difference is the alleged savings.

We are unable to accept El Paso's unsupported $12.71 million figure for alleged future benefits as a substitute for certain refunds with interest probably totalling close to this alleged benefit. Mustang has provided no proof that it will actually pay less for alternate supplies or that El Paso would not be able to renegotiate its contract with OG&E to improve the price terms. El Paso has an on-

going obligation as a prudent purchaser to seek to obtain permanent, renegotiated reductions in purchase prices and take-or-pay obligations. Finally, the alleged settlement benefits fail to reflect the potential detriment of extending the OG&E contract with its take-or-pay obligation another four years. Therefore, we find the alleged settlement benefits of an inadequate, unsupported refund of $3.0 million and unsupported future savings are outweighed by the certain refund probably in excess of $10.4 million [30] (plus interest accrued over the 24-month amortization period) as provided by this order.

Finally, Mustang argues that this case presents certain issues that may not be repeated in current industry circumstances. Mustang goes on to state that because these issues may not re-arise that ". . . further consideration or litigation of those issues before the Commission or the Court of Appeals is not warranted if the Commission can dispose of these dockets by approval of a settlement."[31]

But this case has already completed the final stage before the Commission. In any event, approval of the settlement does not dispose of the very same type of rate and minimum bill issues in any proceedings covering Mustang's rates commencing May 1, 1984, such as Docket No. ST85-559-000, *et al.*[32] Moreover, even if certain is-

---

[30] This figure is a rough estimate based upon the addition of the refunds due under this order as a result of payments pursuant to the unlawful minimum bill (approximately $7.2 million) with those due to rate charges (approximately $260,000). With interest, the total due at this time should be in excess of $10.4 million. The exact amount due will be established after Mustang submits its initial refund report.

[31] Mustang's settlement at 4.

[32] *See* 32 FERC ¶ 61,028 (1985). We note that on April 21, 1986, Mustang filed a petition in Docket No. ST81-260, *et al.*, for the approval of rates for the subject transportations on or after May 1, 1986.

sues may not be raised in future cases, that does not provide sufficient rationale for approval of this settlement offer. The settlement proposal does not adequately address the central issue of this case, i.e., did Mustang charge too much and, if so, what refunds are due? After having found the minimum bill provision to be not fair and equitable, our focus in this case is to assure that the appropriate refunds due to El Paso's customers are made. Mustang, through this settlement proposal, wishes to avoid a substantial refund payment in return for speculative benefits from a third party (OG&E) that, at best, may only approximate what will be directly refunded under this order. Because we are unable to find the settlement proposal fair and reasonable and in the public interest, approval of the settlement under the standards of the NGPA and our own regulations is not appropriate.

For the reasons stated above, we shall reject the settlement.

The Commission orders:

(A) Mustang's offer of settlement is rejected.

(B) The requests for rehearing are granted in part, and denied in part, all as more fully set forth in this order.

(C) Requests for rehearing not specifically addressed herein are denied.

(D) Ordering Paragraph (B) of our June 4, 1985 order, is vacated and refunds and refund reports shall be made as provided in Ordering Paragraph (E) below.

(E) Within 45 days of the issuance of this order, Mustang shall begin to refund, in accordance with the methodology set forth in the body of this order, the following amounts, plus interest calculated in accordance with the Commission's regulations: (i) all amounts collected in excess of the approved rates during October 1, 1982, through

April 30, 1984, and (ii) all amounts collected from October 1, 1982, through April 30, 1984, for volumes not actually transported on behalf of El Paso.

(F) Within ten days of Mustang's first refund installment, Mustang shall file an initial refund report showing the total refund amounts and supporting calculations. Within ten days after the final refund installment is made, Mustang shall file a refund report showing the amounts of refunds and interest paid.

Commissioner Trabandt *dissented.*

Appendix A

Alternative A

	Col. 1 *Total Actual Cost-of-Service Allocated to El Paso Using Projected Volumes*	*Col. 2* *El Paso's Actual Transmission Volumes (Mcf)*	*Col. 3* *El Paso's Unit Rate per Mcf*
Period I [1]	$8,845,105	18,129,678	48.79 cents
Period II [2]	$5,445,023	6,856,131	79.42 cents
Period III [3]	$8,219,579	21,152,127	38.86 cents

Alternative B

	Col. 1 *Total Actual Cost-of-Service Allocated to El Paso*	*Col. 2* *El Paso's Actual Transmission Volumes (Mcf)*	*Col. 3* *El Paso's Unit Rate per Mcf*
Period I [4]	$6,835,764	18,129,678	37.70 cents
Period II [5]	$3,731,743	6,856,131	54.43 cents
Period III [6]	$8,144,428	21,152,127	38.50 cents

[1] Mustang's Request for Rehearing, Appendix C, p. 1.

[2] *Id.*, Appendix D, p. 1.

[3] *Id.*, Appendix E, p. 1.

[4] *Id.*, Appendix H, p. 1.

[5] *Id.*, Appendix F, p. 1.

[6] *Id.*, Appendix G, p. 1. Mustang has changed the beginning of the period from May 23, 1983 to May 1, 1983, but for comparison purposes, we use the data provided.

Commission Order of June 4, 1985

	Cost-of-Service Allocated to El Paso Cogar Compressor	*Other*	*Total*
Period I [7]	$ —	$ —	$7,421,000
Period II [8]	$2,492,488	$7,445,542	$9,937,990
Period III [9]	$2,591,542	$5,583,668	$8,175,210

	El Paso's Projected Transmission Volumes (Mcf)		*El Paso's Unit Rate per Mcf*		
	Cogar Compressor	*Other*	*Cogar Compressor*	*Other*	*Total*
Period I	35,387,500	33,300,000	—	—	22.29 cents
Period II	35,387,500	34,020,000	7.04¢	21.89¢	28.93 cents
Period III	35,387,500	21,125,000	7.32¢	26.43¢	33.75 cents

Mustang's Rates Collected Subject To Refund

	Total Projected Cost-of-Service Allocated to El Paso	*El Paso's Projected Transmission Volumes (Mcf)*		*El Paso's Unit Rate per Mcf*
		Cogar Compressor	*Other*	
Period II [10]	$11,062,000	35,387,500	34,020,000	32.21 cents
Period III [11]	$ 8,266,000	35,387,500	21,125,000	34.30 cents

---

[7] The Commission's June 4, 1985 order proposed no change to the settlement allocation methodology, cost-of-service or rate approved in ST81-261-000 but because Mustang's appendices recompute those numbers for Period I, the settlement figures are reproduced here for comparative purposes. The cost-of-service used in the settlement was taken from Appendix C to Mustang's May 1, 1981 Petition for Rate Approval. Appendix C does not break out the cost of service and rates for the Cogar Compressor Station and Other facilities used by El Paso.

[8] Commission order of June 4, 1985, Appendix A, 31 FERC at p. 61,540.

[9] *Id.*, Appendix B, 31 FERC at p. 61,543.

[10] Mustang's September 30, 1982 Application for Approval of Revised Rate, Schedule No. 1, p. 1.

[11] Mustang's May 23, 1983 Application for Approval of Revised Rate, Schedule No. 1, p. 1.

APPENDIX D

Natural Gas Policy Act of 1978, 15 U.S.C. §§ 3301-3432 (1988):

§ 3371. Authorization of certain sales and transportation

(a) Commission approval of transportation.—

(1) Interstate pipelines—

(A) In general.—The Commission may, by rule or order, authorize any interstate pipeline to transport natural gas on behalf of—

(i) any intrastate pipeline; and

(ii) any local distribution company.

(B) Just and reasonable rates.—The rates and charges of any interstate pipeline with respect to any transportation authorized under subparagraph (A) shall be just and reasonable (within the meaning of the Natural Gas Act).

(2) Intrastate pipelines.—

(A) In general.—The Commission may, by rule or order, authorize any intrastate pipeline to transport natural gas on behalf of—

(i) any interstate pipeline; and

(ii) any local distribution company served by any interstate pipeline.

(B) Rates and charges.—

(i) Maximum fair and equitable price.—The rates and charges of any intrastate pipeline with respect to any transportation authorized under subparagraph (A), including any amount computed in accordance with the rule prescribed under clause (ii), shall be fair and equitable and may not exceed an amount which is reasonably comparable to the rates and charges which

interstate pipelines would be permitted to charge for providing similar transportation service.

(ii) Commission Rule.—The Commission shall, by rule, establish the method for calculating an amount necessary to—

(I) reasonably compensate any intrastate pipeline for expenses incurred by the pipeline and associated with the providing of any gathering, treatment, processing, transportation, delivery, or similar service provided by such pipeline in connection with any transportation of natural gas authorized under subparagraph (A); and

(II) provide an opportunity for such pipeline to earn a reasonable profit on such services.

(Pub.L. 95-621, Title III, § 311(a), Nov. 9, 1978, 92 Stat. 3388.)

APPENDIX E

Regulations under the Natural Gas Policy Act of 1978:

Subpart C—Certain Transportation by Intrastate Pipelines

§ 284.121 Applicability.

This subpart implements section 311(a)(2) of the NGPA and applies to the transportation of natural gas by any intrastate pipeline on behalf of:

(a) Any interstate pipeline, or

(b) Any local distribution company served by any interstate pipeline.

§ 284.122 Transportation by intrastate pipelines.

(a) Subject to the provisions of this subpart and the applicable conditions of Subpart A of this part, any intrastate pipeline may, without prior Commission approval, transport natural gas on behalf of:

(1) Any interstate pipeline; or

(2) Any local distribution company served by an interstate pipeline.

(b) No rate charged for transportation authorized under this subpart may exceed a fair and equitable rate under § 284.123.

(c) Any intrastate pipeline engaged in transportation arrangements authorized under this section must file reports as required by § 284.126.

[Order 436, 50 FR 42495, Oct. 18, 1985]

§ 284.123 Rates and charges.

(a) *General rule.* Rates and charges for transportation of natural gas authorized under § 284.122(a) shall be fair and equitable as determined in accordance with paragraph (b) of this section.

(b) *Election of rates.* (1) Subject to the conditions in §§ 284.8 and 284.9 of this chapter, an intrastate pipeline may elect to:

(i) Base its rates upon the methodology used:

(A) In designing rates to recover the cost of gathering, treatment, processing, transportation, delivery or similar service (including storage service) included in one of its then effective firm sales rate schedules for city-gate service on file with the appropriate state regulatory agency; or

(B) In determining the allowance permitted by the appropriate state regulatory agency to be included in a natural gas distributor's rates for city-gate natural gas service; or

(ii) To use the rates contained in one of its then effective transportation rate schedules for intrastate service on file with the appropriate state regulatory agency which the intrastate pipeline determines covers service comparable to service under this subpart.

(2) (i) If an intrastate pipeline does not choose to make any election under paragraph (b) (1) of this section, it shall apply for Commission approval, by order, of the proposed rates and charges by filing with the Commission the proposed rates and charges, and information showing the proposed rates and charges are fair and equitable. Each petition for approval filed under this paragraph must be accompanied by the fee set forth in § 381.403 or by a petition for waiver pursuant to § 384.106 of this chapter. Upon filing the petition for approval, the intrastate pipeline may commence the transportation service and charge and collect the proposed rate, subject to refund.

(ii) 150 days after the date on which the Commission received an application filed pursuant to paragraph (b) (2) (i) of this section, the rate proposed in the ap-

plication will be deemed to be fair and equitable and not in excess of an amount which interstate pipelines would be permitted to charge for providing similar transportation service, unless within the 150 day period, the Commission either extends the time for action, or institutes a proceeding in which all interested parties will be afforded an opportunity for written comments and for the oral presentation of views, data and arguments. In such proceeding, the Commission either will approve the rate or disapprove the rate and order refund, with interest, of any amount which has been determined to be in excess of those shown to be fair and equitable or in excess of the rates and charges which interstate pipelines would be permitted to charge for providing similar transportation service.

(iii) A Commission order approving or disapproving a transportation rate under this paragraph supersedes a rate determined in accordance with paragraph (b)(1) of this section.

(c) *Treatment of revenues.* The Commission presumes that all revenues received by an intrastate pipeline in connection with transportation authorized under § 284.122(a) and computed in accordance with paragraph (b)(1) of this section have been or will be taken into account by the appropriate state regulatory agency for purposes of establishing transportation charges by the intrastate pipeline for service to intrastate customers.

(d) *Presumptions.* If the intrastate pipeline is charging a rate computed pursuant to § 284.123(b)(1), the rate charged is presumed to be:

(1) Fair and equitable; and

(2) Not in excess of the rates and charges which interstate pipelines would be permitted to charge for providing similar transportation service.

(e) *Filing requirements*—(1) *General rule.* Except as provided in paragraph (e)(2) of this section, within 30

days of commencement of new service, any intrastate pipeline that engages in transportation arrangements under this subpart must file with the Commission a one-time statement that describes how the pipeline will engage in these transportation arrangements, including operating conditions, such as, quality standards and financial viability of the shipper. If the pipeline changes its operations under this subpart, it must amend the statement and file such amendments not later than 30 days after commencement of the change in operations.

(2) *Exception.* Any intrastate pipeline that engages in transportation arrangements authorized under this subpart before December 15, 1985, must file the statement described in paragraph (e)(1) not later than February 1, 1985. Any amendments to this statement must be filed in accordance with paragraph (e)(1).

[44 FR 52184, Sept. 7, 1979, as amended at 44 FR 66791, Nov. 21, 1979; Order 394, 49 FR 35364, Sept. 7, 1984; Order 436, 50 FR 42496, Oct. 18, 1985; 50 FR 52276, Dec. 23, 1985]

§ 284.124 Terms and conditions.

Contracts for the transportation of natural gas authorized under this subpart shall provide that the transportation arrangement is subject to the provisions of this subpart.

§ 284.125 Effectiveness of existing transportation services.

(a) Any transportation service authorized and commenced on or before October 9, 1985, under this subpart or § 284.222 of Subpart G as such subparts were effective before November 1, 1985, may be continued under the terms and conditions that applied prior to November 1, 1985, with the exception of reporting requirements, until the earlier of:

(1) The expiration of the original or extended terms of any authorized transportation arrangement as it was in effect on the date of issuance of this order.

(2) October 9, 1987.

(b) Effective November 1, 1985, the reporting requirements of § 284.126 apply to all transportation authorized under this subpart which commenced either prior to, or subsequent to, November 1, 1985.

[Order 436, 50 FR 42496, Oct. 18, 1985; 50 FR 45908, Nov. 5, 1985]

§ 284.126 Reporting requirements.

(a) *Initial full report.* Within thirty days after commencing transportation under by this subpart, an intrastate pipeline must file with the Commission and the appropriate state regulatory agency an initial full report, signed under oath by a senior official of the company, consisting of an original and five conformed copies to the Commission, containing the following information:

(1) The identity of the intrastate pipeline and the identity, title, mailing address, and phone number of the person or persons with whom to communicate about the transportation arrangement;

(2) A general description of the intrastate pipeline's existing operations;

(3) A description of the transportation including:

(i) The identity of the parties;

(ii) The dates of commencement and projected termination of the service;

(iii) The estimated total and maximum daily quantities of natural gas to be transported by the intrastate pipeline;

(iv) The points between which the natural gas is to be transported by the intrastate pipeline;

(v) The location (*i.e.*, state) of the original source and the location (*i.e.*, state) of the ultimate delivery point of the gas; and

(vi) The rate to be charged.

(4) A statement of the basis upon which the intrastate pipeline determined that the service provided is comparable to service provided for under that rate schedule, if the intrastate pipeline is charging a rate under § 284.123(b)(1)(ii) of this chapter; and

(5) A statement that:

(i) The appropriate state regulatory agency has been notified that the Commission presumes that all revenues received by an intrastate pipeline under rates for transportation under § 284.122 established under § 284.123 (b)(1) of this chapter, have been or will be taken into account by the appropriate state regulatory agency for purposes of establishing transportation rates charged by that intrastate pipeline for service to intrastate customers; and

(ii) Any contract for the transportation arrangement provides that it is subject to this subpart.

(6) If such transportation is provided to a customer that is located in the service area of a local distribution company, a statement that the intrastate pipeline has notified the local distribution company and the local distribution company's appropriate state regulatory agency in writing of the proposed transportation prior to commencement.

(b) *Subsequent reports.* (1) An intrastate pipeline that files an initial report under paragraph (a) of this section must amend that report to reflect any material change with pertinent transportation arrangement.

(2) Any changes in the initial report required by this paragraph must be filed with the Commission and the

appropriate state regulatory agency within 30 days of the material change, and must be signed under oath by a senior official of the company, and consist of an original and five conformed copies to the Commission.

(c) *Annual report.* Not later than May 1 of each year, each intrastate pipeline must file an annual report with the Commission and the appropriate state regulatory agency that contains, for each docketed transportation service provided during the preceding calendar year under § 284.122, the following information:

(1) The docket number assigned to the transaction;

(2) Total volumes transported for the transaction; and

(3) Total revenues received for the transaction.

(d) *Notification of termination.* Not later than thirty days after the termination of any transportation arrangement authorized under § 284.122, the intrastate pipeline must file with the Commission and with the appropriate state regulatory agency a statement, consisting of an original and five conformed copies to the Commission, including the following information:

(1) The docket number assigned to the transaction and the date the transaction was terminated;

(2) The total volumes transported under the arrangement;

(3) The total revenues received; and

(4) A statement certifying that the service was provided under the terms and conditions previously reported in that docket.

(e) *Filing fees.* Each initial report required by paragraph (a) of this section must be accompanied by the fee set forth in § 381.404 of this chapter, or a petition for waiver under § 381.106 of this chapter.

(f) *Reporting form.* Each initial report filed under paragraph (a) of this section and each subsequent report filed under paragraph (b) of this section must utilize FERC Form No. 549-ST.

[Order 436, 50 FR 42496, Oct. 18, 1985, as amended at 50 FR 52276, Dec. 23, 1985; Order 458, 51 FR 44284, Dec. 9, 1986]

APPENDIX F

Pursuant to Rule 28.1, Petitioner lists parent companies (other than wholly owned subsidiaries) and affiliates. The parent corporation is Mustang Fuel Corporation. As of January 1, 1989, the appellant in the proceeding below (Mustang Energy Corp.) was merged into Mustang Production Company which changed its name to Mustang Fuel Corporation. The subsidiaries and affiliates of Mustang Fuel Corporation not wholly owned are:

Mustang Fuel Corporation of Oklahoma
Technical Industries, Inc.

FILED
MAR 24 1989
JOSEPH F. SPANIOL, JR.
CLERK

(3)

No. 88-1177

In the Supreme Court of the United States

OCTOBER TERM, 1988

MUSTANG FUEL CORPORATION, FORMERLY MUSTANG ENERGY CORP., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

WILLIAM C. BRYSON
Acting Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

CATHERINE C. COOK
General Counsel

JOSEPH S. DAVIES
Deputy Solicitor

JOANNE LEVEQUE
Attorney
Federal Energy Regulatory Commission
Washington, D.C. 20426

18 pp

QUESTION PRESENTED

Whether the court of appeals properly upheld the decision of the Federal Energy Regulatory Commission establishing "fair and equitable" rates for petitioner's natural gas transportation service under Section 311(a)(2) of the Natural Gas Policy Act of 1978, 15 U.S.C. 3371(a)(2).

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statement	2
Argument	8
Conclusion	14

TABLE OF AUTHORITIES

Cases:

Bluefield Water Works & Improvement Co. v. *Public Service Comm'n*, 262 U.S. 679 (1923)	11
Covington & Lexington Turnpike Road Co. v. *Sandford*, 164 U.S. 578 (1896)	12
Duquesne Light Co. v. *Barasch*, No. 87-1160 (Jan. 11, 1989)	11, 12
East Tennessee Natural Gas Co. v. *FERC*, No. 87-1765 (D.C. Cir. 1988)	12-13
FPC v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944)	9, 10, 11, 12
Jersey Cent. Power & Light Co. v. *FERC*, 810 F.2d 1168 (D.C. Cir. 1987)	12
Market Street Ry. v. *Railroad Comm'n*, 324 U.S. 548 (1945)	11
Mustang Fuel Corp., 19 F.E.R.C. ¶ 61,168, on reh'g, 20 F.E.R.C. ¶ 61,057 (1982)	3, 13
Mustang Fuel Corp., 31 F.E.R.C. ¶ 61,265 (1985)	1
Mustang Fuel Corp., 36 F.E.R.C. ¶ 61,001 (1986)	1
Pennell v. *San Jose*, 108 S. Ct. 849 (1988)	12
Permian Basin Area Rate Cases, 390 U.S. 747 (1968)	8, 10, 11

Constitution, statutes, and regulations:

U.S. Const. Amend. V (Due Process Clause)	8, 11
Natural Gas Act of 1938, 15 U.S.C. 717 *et seq.*:	
§ 4, 15 U.S.C. 717c (1976)	13
§ 5, 15 U.S.C. 717d (1976)	13

Statutes and regulations – Continued: Page

Natural Gas Policy Act of 1978, 15 U.S.C. 3301 *et seq.*:
§ 311, 15 U.S.C. 3371 13
§ 311(a)(2), 15 U.S.C. 3371(a)(2) 2, 3, 4, 6, 7, 8, 9, 13
§ 311(a)(2)(B)(i), 15 U.S.C. 3371(a)(2)(B)(i) 2
§ 311(a)(2)(B)(ii), 15 U.S.C. 3371(a)(2)(B)(ii) 2
18 C.F.R.:
Section 284.2 13
Section 284.123(b) 4
Section 284.123(b)(1) 2
Section 284.123(b)(2) 13
Section 284.123(b)(2)(i) 4
Section 284.123(b)(2)(ii) 2, 4

Miscellaneous:

H.R. Rep. No. 1752, 95th Cong., 2d Sess. (1978) 8

In the Supreme Court of the United States

OCTOBER TERM, 1988

No. 88-1177

MUSTANG FUEL CORPORATION, FORMERLY MUSTANG ENERGY CORP., PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-31a) is reported at 859 F.2d 1447. The order of the Federal Energy Regulatory Commission establishing petitioner's rates (Pet. App. 34a-62a) is reported at 31 F.E.R.C. ¶ 61,265 (1985). The order of the Federal Energy Regulatory Commission on rehearing (Pet. App. 63a-93a) is reported at 36 F.E.R.C. ¶ 61,001 (1986).

JURISDICTION

The judgment of the court of appeals (Pet. App. 32a-33a) was entered on October 17, 1988. The petition for a writ of certiorari was filed on January 17, 1989 (Tuesday after a Monday holiday). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Under Section 311(a)(2) of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. 3371(a)(2), the Federal Energy Regulatory Commission (FERC or Commission) may authorize an intrastate pipeline to transport natural gas on behalf of any interstate pipeline or local distribution company served by an interstate pipeline. The Commission must establish "fair and equitable" rates and charges for such transportation service that "may not exceed an amount which is reasonably comparable to the rates and charges which interstate pipelines would be permitted to charge for providing similar transportation service." Section 311(a)(2)(B)(i) of the NGPA, 15 U.S.C. 3371(a)(2)(B)(i). In order to set "fair and equitable" rates, the Commission must "establish the method for calculating an amount necessary to * * * reasonably compensate any intrastate pipeline for expenses incurred" and "provide an opportunity for such pipeline to earn a reasonable profit on such services." Section 311(a)(2)(B)(ii) of the NGPA, 15 U.S.C. 3371(a)(2)(B)(ii).

Under the Commission's regulations implementir g Section 311(a)(2), intrastate pipelines may base rates for interstate service on the methodologies used by, or the rates on file with, their respective state regulatory agencies. See 18 C.F.R. 284.123(b)(1). If an intrastate pipeline does not so elect, or is not subject to state regulation, the pipeline must file an application with the Commission for approval of its proposed rates and charges, along with information showing that they are "fair and equitable." See 18 C.F.R. 284.123(b)(2)(ii).

2. Before 1981, petitioner Mustang Fuel Corporation (petitioner or Mustang), a private intrastate pipeline located in Oklahoma, transported natural gas from producing areas to electrical generating stations owned by

Oklahoma Gas and Electric Company (OG&E).[1] In January 1981, petitioner contracted with El Paso Natural Gas Company (El Paso), an interstate pipeline, to transport gas for El Paso through petitioner's existing facilities under Section 311(a)(2) of the NGPA, 15 U.S.C. 3371(a)(2). That agreement also required petitioner to construct a new segment of pipeline, an additional compressor station, and certain gathering lines, all of which were needed to meet El Paso's transportation requirements. Pet. App. 2a, 34a-35a, 64a.

Before transporting gas for El Paso on September 30, 1981, petitioner sought the Commission's approval of a proposed transportation rate of 22.29 cents per Mcf (thousand cubic feet). By orders entered in May and July 1982, the Commission approved a settlement. See *Mustang Fuel Corp.*, 19 F.E.R.C. ¶ 61,168, on reh'g, 20 F.E.R.C. ¶ 61,057 (1982).[2] Petitioner agreed to transport gas for a term of 15 years at an "annual average daily limit of

---

[1] Petitioner was not regulated by any state authority. Pet. App. 5a n.1.

[2] As a threshold matter, the Commission concluded that the "fair and equitable" standard contained in Section 311(a)(2) should be implemented through the Commission's traditional cost-of-service ratemaking principles. In other words, a "fair and equitable rate" is "one that reasonably compensates an intrastate pipeline for expenses incurred by the pipeline for providing the service plus an opportunity for the pipeline to earn a reasonable profit" (*Mustang Fuel Corp.*, 19 F.E.R.C. ¶ 61,168, at 61,318 (1982)).

Under cost-of-service ratemaking, "a unit transportation rate is determined by dividing the total annual (or annualized) cost of providing service (inclusive of a return on the pipeline's investment) by the annual (or annualized) volumes to be transported" (Pet. App. 13a n.10 (internal quotation marks and citations omitted)).

130,000 Mcf" (Pet. App. 36a).[3] For the one-year period ending September 30, 1982 (Period I), the Commission approved petitioner's proposed rate of 22.29 cents per Mcf. Thereafter, by September 30, 1982, and at least once a year for the duration of the period of service, petitioner would seek, under Regulation 284.123(b) (18 C.F.R. 284.123(b)), the Commission's approval of the rates to be charged to El Paso. Pet. App. 35a-36a.

On September 30, 1982, petitioner applied to the Commission for an approximate 50% rate increase, from 22.29 cents per Mcf to 32.21 cents per Mcf. That increased rate would obtain for a period up to twelve months beginning October 1, 1982 (Period II). On May 23, 1983, petitioner requested an additional rate increase to 34.30 cents per Mcf, effective for the twelve-month period beginning on that date (Period III). The Commission scheduled appropriate rate proceedings. In the meantime, under Regulation 284.123(b)(2)(i) and (ii), the Commission accepted petitioner's new rates for filing, subject to refunds to El Paso if it ultimately determined that those rates were excessive under Section 311(a)(2) of the NGPA, 15 U.S.C. 3371(a)(2). Pet. App. 7a, 36a.[4]

3. On June 4, 1985, the Commission issued an order setting fair and equitable rates for petitioner's transportation of gas that were lower than those sought by peti-

---

[3] Under the "minimum bill" provision of the contract between petitioner and El Paso, El Paso would pay petitioner each month for transportation of a "minimum daily quantity," regardless of whether petitioner actually transported and delivered that volume of gas to El Paso. Pet. App. 6a.

[4] Since petitioner filed its second rate increase in May 1983, "Period II" covered the period October 1, 1982 through May 22, 1983. "Period III" covered the period from May 23, 1983 through April 30, 1984. Pet. App. 7a.

tioner.[5] In addition, the Commission invalidated the "minimum bill" provision of petitioner's agreement with El Paso and ordered petitioner to refund any charges collected for natural gas not actually transported for El Paso. Pet. App. 34a-62a.

a. Having concluded earlier to apply cost-of-service ratemaking to the statutory standard of "fair and equitable," see note 2, *supra,* the Commission found that the record did not adequately support the cost projections submitted by petitioner. It therefore substituted petitioner's "actual system-wide cost of service and average rate base for the period ending September 30, 1983, the most current twelve-month period for which Mustang provided unadjusted figures," for petitioner's projected costs (Pet. App. 40a). As a result, the Commission lowered petitioner's proposed rates to 28.93 cents per Mcf for Period II and 33.75 cents per Mcf for Period III (*id.* at 50a, 61a-62a).

b. The Commission also rejected the proposed "minimum bill" provision in the contract between petitioner and El Paso, which permitted petitioner to charge El Paso transportation rates for a minimum of 130,000 Mcf of gas per day, regardless of whether El Paso actually took that quantity (see note 3, *supra*). It explained that the "risk of underutilization of Mustang's facilities should be shared between Mustang and El Paso. This sharing of underutilization risk provides Mustang some incentive to perform Section 311 transportation but to avoid overbuilding Section 311 facilities" (Pet. App. 53a). Since petitioner's minimum bill would have substantially shifted that risk to El Paso, the Commission held that it was not "fair and equitable" (*id.* at 54a).

---

[5] The Commission's order established petitioner's rates only for Period II and Period III (Pet. App. 36a).

c. Finally, having determined that petitioner's proposed rates and minimum bill provision exceeded the statutory "fair and equitable" standard, the Commission ordered petitioner to refund to El Paso those excess funds collected. Pet. App. 62a.[6]

4. The court of appeals (Pet. App. 1a-31a) denied Mustang's petition for review of the Commission's order, except to the extent that it directed the Commission to recalculate the Period II rate by using the "actual cost data" for that term (*id.* at 24a-25a, 31a-33a).

a. The court concluded that the Commission, exercising its discretion to interpret the broad statutory directive contained in Section 311(a)(2) to establish "fair and equitable" rates, had properly chosen to implement the statute through traditional cost-of-service ratemaking, a matter which petitioner did not challenge (Pet. App. 10a-13a). Under such circumstances, FERC has discretion to decide how costs associated with underutilized capacity should be allocated in order to balance its "obligation to interstate ratepayers with the duty to intrastate pipelines under Section 311(a)" (*id.* at 17a). Accordingly, the court chose to "defer to FERC's interpretation of the 'fair and equitable' standard and to its allocation of the risks of underutilization in setting transportation rates" (*id.* at 18a).

b. The court of appeals upheld the Commission's use of actual cost data, as opposed to petitioner's projected

---

[6] In its order, the Commission also invalidated the minimum bill provision in effect for Period I, and thus ordered petitioner to refund excess funds collected during that term. Pet. App. 55a-57a. On rehearing, the Commission agreed with petitioner that such an order, under the circumstances, was wrong. It therefore rescinded that order, permitting petitioner to collect from El Paso under the minimum bill provision until October 1, 1982 (the beginning of Period II). *Id.* at 72a-76a.

cost data, in setting transportation rates, observing that "Mustang has identified no authority to support its contention that the use of actual cost data is improper" (Pet. App. 21a).[7] Moreover, the court rejected petitioner's claim that the Commission engaged in impermissible retroactive ratemaking by switching from projected cost figures for Period I to actual cost figures for Periods II and III. That prohibition applies only to rates that have been finally approved. Here, "FERC regulations make clear that unapproved rates are collected subject to a later refund if the filed rates are determined to be in excess of that which is fair and equitable" (*id.* at 22a). The court thus concluded that FERC's decision to rely on actual cost data is not tantamount to retroactive ratemaking. *Id.* at 22a-23a.

c. The court of appeals also upheld FERC's invalidation of the minimum bill provision, concluding that the reallocation of the risk of underutilization to petitioner resulting from invalidation of that provision was within the Commission's authority. The court dismissed petitioner's claim that the Commission's "order is discriminatory * * * because FERC approved minimum bills for interstate pipelines during the same period" (Pet. App. 27a). In the court's view, the differences between FERC's regulatory jurisdiction over interstate pipelines' transportation of gas and transportation of gas by intrastate pipelines under Section 311(a)(2), together with the Commission's allocation of the risk of underutilization under Section 311(a)(2), supported the Commission's decision to treat minimum bills differently in the intrastate context. Pet. App. 27a-28a.

---

[7] The court agreed with petitioner, however, that the Commission erred in not relying on updated figures reflecting petitioner's actual costs for Period II. Accordingly, it directed the Commission to recalculate the Period II rate by using the "actual cost data" for that term. Pet. App. 24a-25a.

d. Finally, the court of appeals, following *Permian Basin Area Rate Cases,* 390 U.S. 747, 770 (1968), rejected petitioner's contention that the Commission's "refund order which forces it to repay revenues below its actual cost of service is confiscatory and unconstitutional" (Pet. App. 29a). Noting that the Commission's regulations make clear that any Section 311(a)(2) rates collected before final Commission approval are subject to refund, and that a pipeline may seek judicial review of that decision, the court held that FERC's procedures were consistent with the Due Process Clause (*id.* at 31a).

ARGUMENT

The decision of the court of appeals is correct. It does not conflict with any decision of this Court or of any other court of appeals. Accordingly, further review by this Court is not warranted.

1. Petitioner principally contends (Pet. 16-21) that the Commission misapplied the "fair and equitable" standard of Section 311(a)(2) of the NGPA, 15 U.S.C. 3371(a)(2), by not setting rates that would guarantee petitioner the return of a "reasonable profit" and the recovery of "expenses incurred." As the court of appeals recognized, the " 'fair and equitable' standard in Section 311(a)(2) is subject to a variety of interpretations" (Pet. App. 10a). FERC's reasonable construction of the statute it administers merits deference, and the Commission's reading of Section 311(a)(2) finds support in the legislative history (Pet. App. 13a (citing H.R. Rep. No. 1752, 95th Cong., 2d Sess. 107-109 (1978)). Accordingly, the court of appeals correctly upheld the Commission's conclusion that Section 311(a)(2) called for traditional cost-of-service ratemaking (Pet. App. 12a-13a).

Under that established ratemaking methodology, rates are set that give a pipeline an opportunity to recover its costs and earn a profit on its property devoted to the public service. See *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944). In other words, the Commission approves or establishes rates based on appropriately documented costs, which are allocated among the pipeline's customers based on selected volumes of business. If the pipeline surpasses its targeted volume, it will certainly recover the allocated share of costs on its business. If, however, the pipeline does not attain that target, it will not fully recover its costs. Accordingly, although this regulatory regime enables a pipeline to recover expenses and earn a profit, it does not guarantee that outcome where the pipeline's facilities are underutilized.

Here, the Commission correctly set petitioner's rates, taking into account petitioner's actual costs and the fact that its minimum bill provision improperly allowed petitioner to charge El Paso for transportation service it had not rendered. Under Section 311(a)(2) of the NGPA, as the court of appeals recognized, the Commission properly established rates that required petitioner to bear the risk where utilization of its facilities is below the levels which have been established for rate design purposes.

In this regard the Commission views the proper apportionment of the risk of underutilization of new and of existing facilities somewhat differently (Pet. App. 48a). In both instances, however, the Commission's application of Section 311(a)(2), which does not ensure that petitioner will in fact recover expenses and earn a profit from its transportation services, is consistent with the statutory mandate.

The NGPA allows pipelines to build new facilities without first obtaining the Commission's approval. Con-

sequently, it is important that the Commission be able "to encourage the intrastate pipeline to make a sound assessment of the need for and economic viability of the facilities" (Pet. App. 16a (emphasis and citation omitted)). In this instance the Commission, through a condition established at the outset of the Mustang-El Paso service, required that rates filed by Mustang to cover costs on its major new facility be predicated on a specified minimum level of volumes; then, if there were excessive levels of unused capacity, the risk would fall on the project's builder, not the utility ratepayer.

Most of Mustang's facilities predated the NGPA and the Commission here gave petitioner the opportunity to recover its costs and earn a return on equity if the pipeline met the levels of service reflected in the rates petitioner itself filed.[8] If petitioner's actual volume of transportation fell below the levels petitioner forecasted, it either could seek out additional customers or file new rates with adjusted targeted levels. This regulatory regime thus clearly satisfies the statutory standard for ratemaking.

2. a. Petitioner further contends (Pet. 21-26) that the decision below conflicts with constitutional principles articulated in decisions such as *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944), and *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968). But as mentioned above, the regulatory regime, which gave petitioner the opportunity

---

[8] Petitioner also contends that the Commission's "orders have shoved up on an intrastate pipeline 100% of the financial impact of El Paso's, and its customers' misjudgments of their markets and errors in their projections between 1982 and 1985" (Pet. 23). That claim is groundless. Although El Paso makes the initial projections, petitioner need not accept those estimates. Absent the artificial protection of a minimum bill provision, petitioner will likely scrutinize El Paso's projections in order to make certain that its proposed rate will reflect its actual costs. See Pet. App. 27a.

to recover its costs and earn a return on equity if the pipeline met the levels of service reflected in the rates petitioner itself filed, clearly satisfies constitutional requirements for ratemaking.

As this Court recently explained in *Duquesne Light Co.* v. *Barasch,* No. 87-1160 (Jan. 11, 1989), slip op. 14, a regulated utility is entitled to earn a return on property used to carry out its public service obligation comparable to that which would be available under competitive conditions for businesses with similar risks. See *FPC* v. *Hope Natural Gas Co.,* 320 U.S. at 603; *Bluefield Water Works & Improvement Co.* v. *Public Service Comm'n,* 262 U.S. 679, 692-693 (1923). That fundamental principle does not require, as petitioner has suggested (see Pet. App. 13a), that the regulating authority insure utilities against losses from failed business ventures or impose such losses on customers who have not benefitted from the utilities' expenditures. For as the Court explained in *Market Street Ry.* v. *Railroad Comm'n,* 324 U.S. 548, 566 (1945), the Due Process Clause does not require that "regulation * * * assure that the regulated business make a profit." Nor may that Clause "be applied to insure values or to restore values that have been lost by the operation of economic forces" (*id.* at 567).

b. Contrary to petitioner's contention (Pet. 24-26), the court of appeals correctly applied the so-called "end result" test set forth in *Hope Natural Gas.* Under that test, "it is the result reached [by operation of a utility's rate order] not the method employed which is controlling" (320 U.S. at 602). As the Court explained, "[i]f the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry * * * is at an end" (*ibid.*); see *Permian Basin Area Rate Cases,* 390 U.S. 747, 769-770 (1968). The "guiding principle has been that the Constitution protects utilities from being limited to a charge for

their property serving the public which is so 'unjust' as to be confiscatory" (*Duquesne Light Co.*, slip op. 7); see *Pennell* v. *San Jose*, 108 S. Ct. 849, 857 (1988); *Covington & Lexington Turnpike Road Co.* v. *Sandford*, 164 U.S. 578, 597 (1896).

Here, the "end result" of the Commission's order gives petitioner the opportunity to earn a return comparable to that earned by firms with similar risks, but only on the services petitioner actually provides. The Commission's order therefore requires petitioner to repay rates collected under its minimum bill for volumes of gas it never transported for El Paso, as well as to reduce its rates to reflect actual costs (since petitioner did not adequately support its cost projections). That sound result certainly satisfies the standard announced in *Hope Natural Gas.*[9]

3. Finally, petitioner asserts (Pet. 26-27) that the court of appeals' treatment of the Commission's invalidation of the minimum bill provision conflicts with *East Tennessee Natural Gas Co.* v. *FERC*, No. 87-1765 (D.C. Cir. Dec. 9,

---

[9] Petitioner also asserts (Pet. 27-28) that the court of appeals' decision conflicts with *Jersey Cent. Power & Light Co.* v. *FERC*, 810 F.2d 1168 (1987) (en banc). In that case, the District of Columbia Circuit held that, under *Hope Natural Gas, supra*, the Commission had erred in not adequately considering the utility's request to earn a return on expenditures for a cancelled nuclear power plant, where the utility claimed that it "has been shut off from long-term capital, is wholly dependent for short-term capital on a revolving credit arrangement that can be cancelled at any time, and has been unable to pay dividends for four years" (810 F.2d at 1181). Unlike the utility in *Jersey Cent. Power & Light Co.*, petitioner has made no showing that it faces that "sort of deep financial hardship" as a result of the Commission's ratemaking (810 F.2d at 1181 n.3). On the contrary, the Commission's action, after holding hearings, afforded petitioner a fair opportunity to collect its actual cost of service and a reasonable rate of return on equity in light of the risks of its enterprise. The court of appeals' decision is thus consistent with *Jersey Cent. Power & Light Co.*

1988). In that case, the District of Columbia Circuit held that the Commission, in connection with proposals for rate changes under Sections 4 and 5 of the Natural Gas Act, 15 U.S.C. 717c and 717d, may eliminate a minimum bill provision retroactively only where "[a]n interaction between proposed changes and existing rates * * * will *create* results that are unjust or unreasonable under *existing* Commission policy as it applies to the pipeline at the time it files its proposed rate changes" (slip op. 21 (emphases in original)). The instant case, however, does not involve the same situation.

Here, the case does not arise under Sections 4 and 5 of the Natural Gas Act, but under the different regulatory structure of Section 311 of the NGPA. Moreover, the Commission's order approving petitioner's Period I rates and initially authorizing petitioner's transportation service under Section 311(a)(2) of the NGPA cannot be construed as an open-ended approval of petitioner's rates or its minimum bill requirement. To the contrary, that order specifically required petitioner to file entirely new rate applications each year. *Mustang Fuel Corp.*, 19 F.E.R.C. ¶ 61,168, on reh'g, 20 F.E.R.C. ¶ 61,057 (1982); see Pet. App. 35a-36a. Under the Commission's rules, that meant petitioner had to apply for Commission approval of the rates each year, show that they were fair and equitable (18 C.F.R. 284.123(b)(2)), and refund any portions the Commission did not approve (18 C.F.R. 284.2). The Commission's action here was squarely in accordance with those established regulations and its earlier order.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

WILLIAM C. BRYSON
Acting Solicitor General

CATHERINE C. COOK
General Counsel

JOSEPH S. DAVIES
Deputy Solicitor

JOANNE LEVEQUE
Attorney
Federal Energy Regulatory Commission

MARCH 1989

☆ U.S. GOVERNMENT PRINTING OFFICE: 1989—241-699/00170

FILED
MAR 31 1989
JOSEPH F. SPANIOL
CLERK

No. 88-1177

IN THE
Supreme Court of the United States
OCTOBER TERM, 1988

MUSTANG FUEL CORPORATION (formerly MUSTANG ENERGY CORP.),
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

REPLY BRIEF OF PETITIONER TO BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION

DAVID O. CORDELL
MUSTANG FUEL CORPORATION
2000 Classen Center
800 East
2000 Classen Blvd.
Oklahoma City, OK 73106
(405) 557-9400

CARROLL L. GILLIAM *
RICHARD A. DROM
CATHERINE E. BOCSKOR
GROVE, JASKIEWICZ, GILLIAM AND COBERT
1730 M Street, N.W.
Washington, D.C. 20036
(202) 296-2900

* Counsel of Record

March 31, 1989

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

TABLE OF CONTENTS

	Page
STATEMENT	1
ARGUMENT	2
CONCLUSION	9

TABLE OF AUTHORITIES

Cases:

Colorado Interstate Gas Company v. *FERC*, 791 F.2d 803 (10th Cir. 1986), cert. den., 107 S. Ct. 907 (1987)	5
East Tennessee Natural Gas Company v. *FERC*, 863 F.2d 932 (D.C. Cir. 1988)	2, 4
Jersey Central Power & Light Company v. *FERC*, 810 F.2d 1168 (D.C. Cir. 1987) (*en banc*)	7
Tennessee Gas Pipeline v. *FERC*, 867 F.2d 688 (D.C. Cir. 1989)	2, 3, 4, 8
Tennessee Gas Pipeline v. *FERC*, No. 87-1368 (D.C. Cir., Mar. 10, 1989)	4

Statutes and Regulations:

Natural Gas Act of 1938, 15 U.S.C. § 717, *et seq.*:	
Section 4, 15 U.S.C. § 717c (1976)	4, 5
Section 5, 15 U.S.C. § 717d (1976)	4, 5
Natural Gas Policy Act of 1978, 15 U.S.C. § 3301 *et seq.*:	
Section 311(a)(2), 15 U.S.C. § 3371(a)(2)	2, 4, 8
Section 311(a)(2)(B)(ii), 15 U.S.C. § 3371 (a)(2)(B)(ii)	5

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

No. 88-1177

MUSTANG FUEL CORPORATION (formerly MUSTANG ENERGY CORP.),
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

---

REPLY BRIEF OF PETITIONER TO BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION

Pursuant to Rule 22.5, Petitioner Mustang Fuel Corporation (formerly Mustang Energy Corp.) replies to the Brief for the Federal Energy Regulatory Commission filed on March 24, 1989.

STATEMENT

New decisions in the D.C. Circuit since the filing of the petition by Mustang Fuel Corporation ("Mustang") on January 17, 1989: (1) support Mustang's assertion of conflicts among the circuits as to lawfulness of retro-

active elimination of a contractual minimum bill by the Federal Energy Regulatory Commission ("Commission"); (2) add to reasons this Court should grant Mustang's petition, and (3) negate the Commission's assertions that no conflicts exist and further review by this Court is unwarranted.

ARGUMENT

The Commission's brief in opposition seeks to establish that the Commission correctly applied the "fair and equitable" standard of Section 311(a)(2) of the NGPA, 15 U.S.C. 3371(a)(2), and that there are no conflicts among the circuits as to issues decided by the Tenth Circuit in this case.

1. As Mustang has shown, the Tenth Circuit decision conflicts with recent D.C. Circuit opinions. In both *East Tennessee Natural Gas Company* v. *FERC*, 863 F.2d 932 (D.C. Cir. 1988), and *Tennessee Gas Pipeline* v. *FERC*, 867 F.2d 688 (D.C. Cir. 1989), agreements between the pipelines and their customers contained mechanisms to protect the pipeline from underrecovery of fixed costs (a minimum bill in the first case and a similar "demand charge" in the latter). In both cases, the D.C. Circuit remanded to the Commission because of the Commission's attempts to eliminate the billing provision retroactively. See Pet. Br. 26-27.

More recent opinions by the D.C. Circuit further support Mustang as to the conflict between the Tenth and D.C. Circuits. On February 10, 1989, the D.C. Circuit reaffirmed its December, 1988 *East Tennessee* opinion in *Tennessee Gas Pipeline* v. *FERC*, 867 F.2d 688. In the latter case, despite a contractual agreement between the pipeline and its customers for transportation service based on a one-part demand rate, the Commission attempted to require the company to substitute a two-part rate that included a "commodity charge" and a "demand charge." 867 F.2d 688, slip op. at 5. The court

found that the Commission had failed to explain this shift of policy and effort to prevent Tennessee from charging the contractually-agreed "one-part" rate, consisting exclusively of a demand charge.[1]

The court noted that a minimum bill is similar to a demand charge in that it is payable regardless of the customer's actual gas purchases. 867 F.2d 688, slip op. n.3 at 5.

In discussion of the one-part demand rate, the D.C. Circuit observed that the pipeline had repeatedly pointed out that the Commission had in the past allowed a one-part demand rate for new facilities for customers who contracted to pay in that manner. 867 F.2d 688, slip op. at 9. In addition, as here, the Commission had previously approved the pipeline's one-part demand rate in passing upon an earlier filing concerning the same transportation service. 867 F.2d at 688, slip op. at 4. The D.C. Circuit stated that the Commission cannot, without adequate explanation, so set aside "expectations" memorialized in contracts and allowed by the Commission itself in earlier proceedings:

> As we have said more than once before, "[t]he Commission may not 'cavalierly disregard[] private contracts' in exercising its authority under the NGA." *Tennessee Gas Pipeline Co. v. FERC*, 824 F.2d 78, 82 (D.C. Cir. 1987) (quoting *ANR Pipeline Co. v. FERC*, 771 F.2d 507, 519-520 (D.C. Cir. 1985)).
>
> . . . The technical fact that the Phase 2 settlement agreement "supersedes" Phase 1 hardly eradicates the contracts or the Commission's prior blessing. The costs are sunk and the contracts long dry. As in

---

[1] A "demand charge" is a rate paid by customers of a pipeline which rate is set according to the number of units of gas the customer is entitled to buy or ship. *Tennessee Gas Pipeline* v. *FERC*, 867 F.2d 688, slip op. at 2.

> the earlier *Tennessee* case, the Commission's rejection of the contracts here seems distinctly cavalier.

867 F.2d 688, slip op. at 10.[2]

Facts here are similar, and so is the law under the Natural Gas Act and the NGPA. Here, parties also had contractually agreed to the minimum bill and the provision was left unchanged in a settlement approved by the Commission in 1982. However, in the next rate filing in which the minimum bill was *not* put in issue by Mustang, the Commission, nevertheless, eliminated that billing provision retroactively despite its prior approval of minimum bills in this and other cases (App., 6a-8a, 27a-28a). The D.C. Circuit, unlike the Tenth, would hold this reversible error.

The Commission's brief in opposition seeks to distinguish the *East Tennessee Natural Gas Co.* v. *FERC* case (and presumably would similarly so seek to distinguish the D.C. Circuit's February 10, 1989 *Tennessee Gas* decision), only by stating that Sections 4 and 5 of the Natural Gas Act ("NGA"), 15 U.S.C. 717c and 717d, were involved in the *East Tennessee* case, whereas the Mustang case involved the different regulatory structure of Section 311 of the Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. 3371(a)(2). Comm. Br. 13. Yet, below and here, the Commission continuously relies upon NGA authorities and decisions to justify its construction and application of Section 311(a)(2) of the NGPA.

The Tenth Circuit, however, was not as persuaded as to any such significant "distinction" between minimum

---

[2] See also *Tennessee Gas Pipeline Co.* v. *FERC*, No. 87-1368 (D.C. Cir. Mar. 10, 1989), slip op. 24, n.20, in which the D.C. Circuit addressed an intervenor's argument that the minimum bill should have been eliminated retroactively. The court concluded that this argument may be precluded by the court's decision in *East Tennessee Natural Gas Pipeline* v. *FERC*, 863 F.2d 932 (D.C. Cir. 1988).

bills under Sections 4 and 5 of the NGA and under Section 311 of the NGPA. The Tenth Circuit thus relied solely on NGA cases in issuing its decision approving the retroactive elimination of Mustang's minimum bill including *Colorado Interstate Gas Company* v. *FERC*, 791 F.2d 803 (10th Cir. 1986), cert. denied, 107 S.Ct. 907 (1987). App., 23a. This reliance on NGA cases by the Tenth Circuit underscores not only the importance of this case as a case of first impression in interpreting Section 311(a)(2) of the NGPA, but also the conflict with the D.C. Circuit's holdings.

2. In its argument as to the "fair and equitable" standard of Section 311(a)(2), the Commission states that this section ". . . does not ensure that petitioner will in fact recover expenses and earn a profit from its transportation services," and its application is consistent with the statutory mandate. Comm. Br. at 9. However, here, as below, the Commission indulges in a pretense that Mustang claims a "guarantee" of cost recovery and profit under this section (Comm. Br. at 8). This is not so.

The plain language of the statute, as Mustang has shown, mandates simply that the Commission *shall* "provide an opportunity for such pipeline to earn a reasonable profit." § 311(a)(2)(B)(ii)(II). App., 3a. Since at least 1982, the Commission has consistently ignored this clear statutory mandate in application of Section 311(a)(2) to intrastate pipelines. The Commission well may have "discretion" to apply a definition of "fair and equitable" rates under this section, but it cannot lawfully ignore Congress' precise statutory elaboration of exactly what the essential elements of "fair and equitable" rates are (namely, reasonable compensation to the intrastate pipeline for expenses incurred and provision for an opportunity to earn a reasonable profit. Section 311(a)(2)(B)(ii) of the NGPA). The Commission has not allowed the required opportunity, and its actions would be re-

versed by the D.C. Circuit under that court's constructions of analogous sections of the Natural Gas Act.

3. The Commission also takes issue with Mustang's contention that the Commission's orders place upon Mustang 100 percent of the burden of the customer's mistakes in projections of throughput volumes. The Commission characterizes this claim as groundless because, "although El Paso makes the initial projections, petitioner need not accept those estimates." See Comm. Br. 10, n.8.

This new-found Commission argument is, in fact, inaccurate and contrary to the El Paso-Mustang contract. Under that agreement, the projected volumes and the minimum daily quantity to be transported by Mustang for El Paso were totally controlled by El Paso. Contrary to the Commission, Mustang never had such a choice of rejecting El Paso's projected volumes. *If* Mustang did not plan to provide transportation of volumes projected by El Paso each year and did not provide sufficient available pipeline capacity to transport those projected volumes, Mustang could have been in breach of the contract for failure to provide this required capacity. Mustang thus had *no* basis or legal power to "not accept El Paso's estimates" as here suggested by the Commission in its brief. On this point, the Commission now errs as to facts as well as law.

4. The Commission also ignores the significance of minimum bills as mechanisms in transportation agreements designed to protect transporters from inaccurate projections by shipper customers. In disregard of the contractual *quid-pro-quos* and elimination of minimum bills retroactively, the Commission applies similar circular reasoning. Here, for example, it brushed aside impact with the supposition that "absent a minimum bill provision, we believe that Mustang will seek to get as accurate an estimate from El Paso as possible, so that its proposed rate will reflect its actual costs." App. 27a, 77a.

Mustang, like other companies, thus has been placed in a "Catch-22" posture whereby the Commission (1) first approves a settlement involving provision of a long-term transportation agreement including a minimum bill; (2) the companies then act in reliance upon such Commission approval; but (3) later, the Commission retroactively eliminates the minimum bills. The Commission then says: "Without the minimum bill you will be forced to try harder to get an accurate projection of yearly volumes from El Paso." Yet, by the time minimum bills are so eliminated retroactively, the transportation involved has long-since been completed so that transporters cannot, after the fact, "seek to get as accurate an estimate from El Paso as possible."

The ultimate result of such treatment of intrastate pipelines, as here, is retroactive shifting of the entire burden of accuracy of projections from the interstate pipeline and its stockholders to the intrastate pipeline, despite the interstate pipeline's agreement to a minimum bill. Here, the result is retroactive imposition of a refund liability of over $11 million, an amount in excess of Mustang's total net income from all of its customers for the year in which the refund was ordered. Pet. Br. 11, App., 83a. Such an "end result" is illegal under the Natural Gas Act and should likewise be condemned under the NGPA substantive standards.[3]

The Commission's brief, nevertheless, tries to show that Commission actions still afforded Mustang a fair "opportunity" to collect its actual cost of service and a reasonable rate of return on equity consistent with the holding in *Jersey Central Power & Light Company* v. *FERC*, 810 F.2d 1168 (1987) (en banc). Comm. Br. 12. This also is not so. In shifting all the risks of under-

---

[3] See *Duquesne Light Co., et al.* v. *Barasch, et al.*, —— U.S. —— (No. 87-1160, Jan. 11, 1989); *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968); and *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944).

utilization to Mustang *after the fact*, the Commission has ordered a refund which exceeded Mustang's total net income for the year ordered and imposed confiscatory rates and refund orders.

5. The Commission argues that its 1982 order approving Mustang's Period I rate structure (which contained a minimum bill) and initially authorizing Mustang's service under Section 311 of the NGPA [4] cannot be construed as open-ended approval of rates or the minimum bill because Mustang was required to file a new rate application each year. Comm. Br. 13.

Mustang did so file the required new rate application each year, but in its filings did not place the minimum bill in issue, but sought only a specific rate increase. The Commission itself put the minimum bill in issue by *sua sponte* eliminating the minimum bill, and this is the very type of action the D.C. Circuit struck down in *Tennessee Gas Pipeline v. FERC* on February 10, 1989. That court emphasized that the Commission cannot so set aside expectations memoralized in contracts and sanctioned by the Commission in prior proceedings without required findings and adequate explanations. 867 F.2d 688, slip op. at 10.

In sum, decisions by the D.C. Circuit since the petition was filed further show the Commission arguments are

---

[4] The Tenth Circuit opinion at issue here covered Periods I (Oct. 1, 1982-May 22, 1983) and II (May 23, 1983-Apr. 30, 1984) only. The rates for Periods III (May 1, 1984-Apr. 30, 1985) and IV (May 1, 1985-Apr. 30, 1986) are still pending at the Commission under Docket Nos. ST81-260-005, et al. All four of these currently are the subject of settlement negotiations by and among Mustang, the Staff of the Commission, and El Paso. If the settlement of these dockets currently under discussion were agreed to, that settlement would encompass the two periods covered by the Tenth Circuit opinion and the subject of the petition for writ of certiorari. If a settlement were agreed upon, approved by the Commission and final and no longer subject to judicial review, the petition in this case would be withdrawn.

without merit and provide no basis for denying Mustang's petition for writ of certiorari.

CONCLUSION

For the reasons stated in the petition and this reply brief, this Court should grant Mustang's petition, consider the "Questions Presented" (Pet. i), and reverse the court of appeals on those questions.

Respectfully presented,

DAVID O. CORDELL
MUSTANG FUEL CORPORATION
2000 Classen Center
800 East
2000 Classen Blvd.
Oklahoma City, OK 73106
(405) 557-9400

CARROLL L. GILLIAM *
RICHARD A. DROM
CATHERINE E. BOCSKOR
1730 M Street, N.W.
Washington, D.C. 20036
(202) 296-2900

* Counsel of Record

Of Counsel:
GROVE, JASKIEWICZ, GILLIAM AND COBERT
1730 M Street, N.W.
Washington, D.C. 20036
(202) 296-2900

March 31, 1989